

Office of the Under Secretary of Defense (Comptroller) (OUSD(C))



Preparation for a Real Property Audit Course

Student Guide

Prepared by:
Science Applications International Corporation
Southbridge Hotel and Conference Center
14 Mechanic Street, Room C-3100
Southbridge, MA 01550-2570



Products or brand names mentioned in the text of this guide
are trademarks or registered trademarks of their respective holders

Course Title	Preparation for a Real Property Audit	
Course Identification	Course Code: OSD-RPA	Course Type: F
Level and Type	Introductory Functional Course	
Course Length	8 hours	8 CPE credit hours
Field of Study	Accounting and Audit, Government Accounting and Reporting – Specialized.	
Course Description	<p>The Preparation for a Real Property Audit course, Version 1.0, is an eight-hour, introductory functional course designed help students understand how to prepare for real property audits that relate to the annually audited financial statements. This course focuses on providing students with the necessary tools to prepare for completing a successful real property audit. After defining the composition of real property and reporting requirements, students learn valuation techniques. The course concludes by examining the assertion process. Students will learn how virtually every DoD job, whether financial or non-financial, contributes to specific components of the financial statements.</p>	
Learning Objectives	<p>Upon completion of this course, the student will be able to:</p> <ul style="list-style-type: none">• analyze components of real property on the DoD financial statements• determine how to evaluate real property for proper valuation• describe how available tools help achieve audit compliance.	
Presentation Mode	<p>The primary methods of instruction are conference, questions, discussion, reviews (practice exercises), and a final examination.</p>	
Who Should Attend	<p>The audience for this course is civilian and military personnel of various grades and ranks. It consists of both financial and non-financial personnel who desire to improve their operations while satisfying Congressional and regulatory audit requirements.</p>	

Prerequisites There are no prerequisites for this course.

Course Agenda

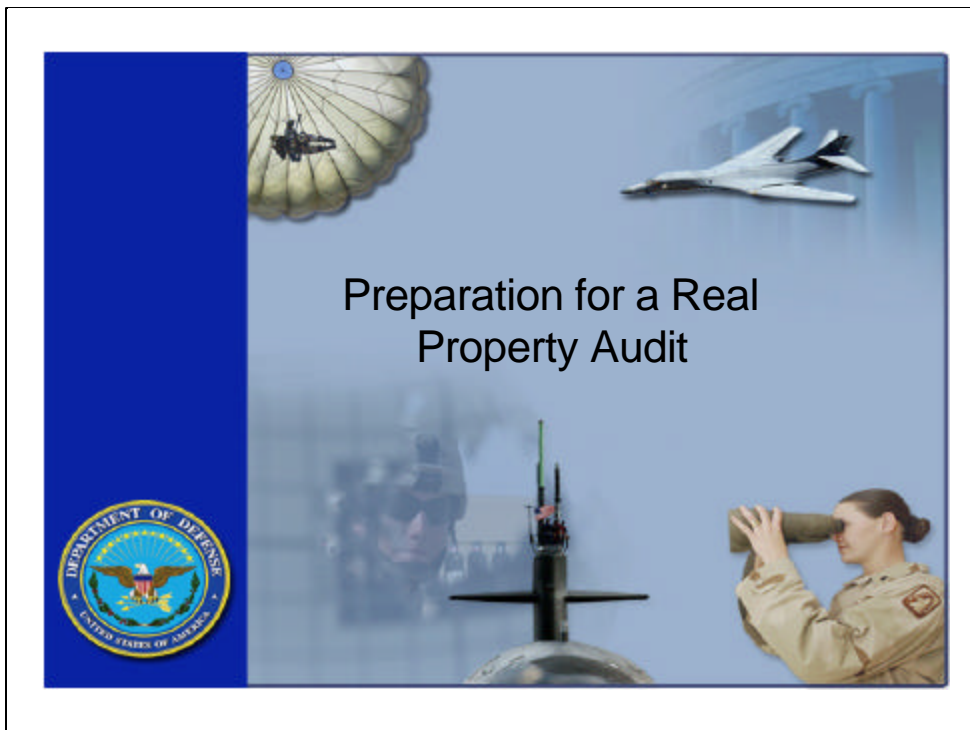
8:00-8:10	Course Introduction
8:10-9:30	Lesson 1 – Defining Components of Real Property
9:30-11:40	Lesson 2 – Recording and Validating Real Property
11:50-12:50	Lunch
12:50-3:30	Lesson 3 – Using Tools to Prepare for Audits
3:30-3:40	End-of-Course Review
3:50-4:30	Final Examination and Final Examination Review
4:40-5:00	Course Critique

Table of Contents

Course Description.....	CD-1
Foreword.....	i
Course Introduction.....	CI-1
Lesson 1 – Defining Components of Real Property	L1-1
Real Property.....	L1-4
Buildings, Structures, and Facilities	L1-12
Capital Improvements.....	L1-16
Standards and Guidance.....	L1-19
Validating Reporting of Statements and Checklist Integrity.....	L1-27
Lesson Summary.....	L1-36
References	L1-37
Review 1. Real Property Requirements and Financial Statements Practice Exercise	R1-1
Lesson 2 – Recording and Validating Real Property	L2-1
Recording Real Property Inventory	L2-5
Preponderant Use	L2-11
Construction-In-Progress	L2-20
Financial Statements Implications for Construction Agents	L2-29
Financial Statements Implications for Users	L2-34
Business Rules	L2-36
Using the Checklist to Identify Supporting Documentation.....	L2-40
Lesson Summary.....	L2-47
References	L2-48
Review 2. Real Property Process Practice Exercise	R2-1
Lesson 3 – Using Tools to Prepare for Audits	L3-1
Legislative and Regulatory Requirements	L3-5
FAM and GAO Yellow Book	L3-15
Internal Control.....	L3-20
Rules for Real Property.....	L3-23
Roles and Responsibilities	L3-33
Discovery and Correction	L3-41
Validation.....	L3-50
Assertion	L3-57
Assessment.....	L3-65
Audit.....	L3-73
Establishing Accountability.....	L3-80
Lesson Summary.....	L3-104
References	L3-106
Review 3. Process Memo and Checklist Practice Exercise	R3-1

End-of-Course Review.....	R-1
Appendix A	A-1
Appendix B	B-1
Appendix C	C-1

This page intentionally left blank.

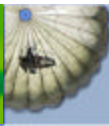


Good morning and welcome to the Preparation for a Real Property Audit course.

This course is presented in three lessons designed to help you analyze components of real property and their ultimate reporting on the DoD financial statements.

The course will also help you understand how to evaluate real property for proper recording and how some of the available tools will help you prepare for the assertion process to achieve audit compliance.

But, before we get into more in-depth information, let's discuss some important points.



Course Introduction





- **Meet your instructor**
- **Housekeeping issues**
- **Other**



Since we are going to be together all day, I would like to start by introducing myself.








I am _____ and... (name, background, and what makes you uniquely qualified to instruct this course).















Now let's talk about a few general housekeeping topics.

Icon Definitions

Course/Lesson Flow	
	Logistics
	Starting Time
	Objectives
	Summary
	Questions
	Exercise/ Exam
	References

Course Topics	
	Key Point
	Definition
	Background
	Detail
	Law/ Standard
	Example
	Report
	Steps
	Goal
	Quote
	Tools
	Information
	Best Practice
	Issues/ Resolutions

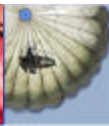
Version 1.0
Preparation for a Real Property Audit
CI-4

Notice that each page is formatted with a header. The left corner of each header contains an icon that provides a visual key to the contents of the page. For example, this page displays the Logistics icon.

The main icons describe course and lesson objectives and introduce key topics. Additional icons within each topic represent definitions, background information, and issues and resolutions. Best Practice and Lessons Learned icons will show examples of successful practices implemented by the government or industry. At the conclusion of each lesson, icons will represent the lesson summary, questions and answers, final examination, and links to references available for more information.

Please feel free to take notes on your student materials and to write down any questions that you may have that we may not have had time to address during the discussion of a particular topic. Your questions are very important to us, but we may not have the answer or sufficient time available in the classroom and may have to go to an outside source for an answer.

Now let's examine the course agenda.



Course Agenda



Time	Title
8:00 – 8:10	Introduction
8:10 – 9:30	Lesson 1, Defining Real Property Components and Practice Exercise
9:30 – 11:40	Lesson 2, Valuing and Validating Real Property and Practice Exercise
11:50 – 12:50	Lunch
12:50 – 3:30	Lesson 3, Using Tools to Prepare for Audits and Practice Exercise
3:30 – 3:40	End-of-Course Review
3:50 – 4:30	Final Examination and Final Examination Review
4:40 – 5:00	Course Critique

Version 1.0

Preparation for a Real Property Audit

CI-5

This is our road map for the day.

Class starts promptly at 8:00 a.m. and will break for ten minutes each hour.

Lunch is scheduled from 11:50 to 12:50 and class ends at 5:00 p.m.

In this course there are three lessons, three practice exercises, and a final examination. Lessons 1 and 2 will be completed before lunch and Lesson 3 will be completed after lunch.

Finally, you will complete a course critique and the instructor will distribute the course completion certificates.

Let's discuss the purpose and objectives.



Course Overview



This course examines how to prepare for a real property audit of the financial statements, with focus on the tools used.

Version 1.0

Preparation for a Real Property Audit

CI-6

This course is designed to help you understand how to prepare for real property audits that relate to the annually audited financial statements.

The focus is on providing you with the necessary tools to prepare for a successful real property audit.

After defining the composition of real property and the reporting requirements, you will learn recording techniques.

The course will conclude with information on the assertion process.

Let's look at the course objectives.



Course Objectives

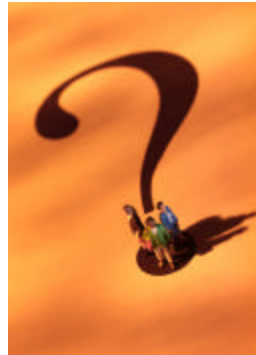
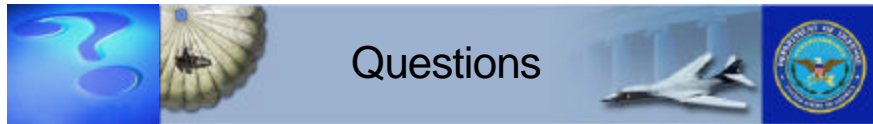


Upon successful completion of this course, you will be able to:

- **Analyze components of real property on the DoD financial statements**
- **Determine how to record costs on the financial statements for real property**
- **Describe how available tools help achieve audit compliance**

This course will convey the skills necessary for you to help the DoD achieve a clean or unqualified audit opinion.

Upon successful completion, you will be able to analyze components of real property on the Department's financial statements, determine how to evaluate real property for valuation, and describe how available tools help achieve audit compliance.

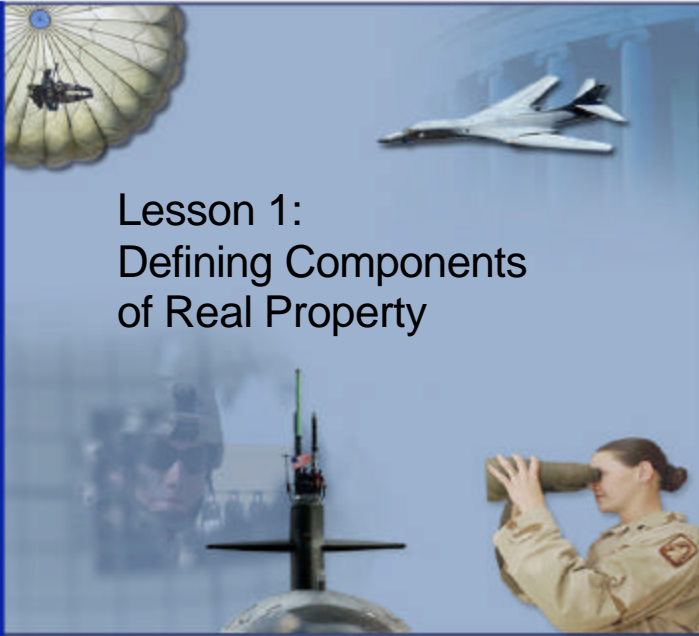


Before we proceed with Lesson 1, Defining Components of Real Property, are there any questions?

Preparation for a Real Property Audit



Lesson 1: Defining Components of Real Property



In Lesson 1, we explore the critical components of real property from several points of view, all with the aim to help you become better prepared for a real property audit.

Let's discuss the lesson objectives.



Upon successful completion of this lesson, you will be able to:

- **Explain the composition of real property**
- **Describe how to report real property**
- **Illustrate the integrity of the annual financial statements**

This lesson examines the various components of real property and then describes how they are reported on the financial statements. We also look at the proofs used to ensure the integrity of the information being presented. Finally, there is a review exercise to reinforce your learning and retention.



Lesson Topics



This lesson contains the following topics:

- **Real Property**
- **Buildings, Structures, and Facilities**
- **Capital Improvements**
- **Standards and Guidance**
- **Validating Reporting of Statements and Checklist Integrity**
- **Review Exercise**

Version 1.0

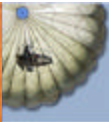

Preparation for a Real Property Audit

L1-3



In this lesson, we discuss the components of real property. We examine the definition of land and take a look at how the government categorizes its real property holdings. The Department's real property capitalization threshold is discussed with regard to its affect on the annual financial statements. We also take a look at the various types of buildings, structures, and facilities that the Department maintains and how real property improvements affect the financial statements.

We discuss departmental regulations, as well as policy and guidance established by the governing boards. A discussion of proof of statements, that is, comparing the financial statements with applicable detailed notes, and checklist integrity is the final topic. Here we illustrate the integrity of the annual financial statements with emphasis on the Balance Sheet.

At the conclusion of this lesson, we will perform a Review Exercise to reinforce the concepts covered.



Real Property



Real Property per Functional Area	Real Property per Financial Area
Functional Definition <ul style="list-style-type: none">• Land• Facilities (buildings, structures, and utilities)	Financial Definition <ul style="list-style-type: none">• Land• Buildings• Structures• Facilities• Construction-in-progress (CIP)

Version 1.0

Preparation for a Real Property Audit

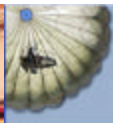
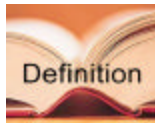
L1-4

The definition of real property differs from functional to financial areas. Real property consists of land, buildings, structures, and facilities. Auditors and accountants consider construction-in-progress (CIP) as a further category of real property.

Volume 4, Chapter 6, DoDFMR prescribes the accounting standards and policy for DoD real property. This chapter defines the type of assets, capitalization procedures, and by functional (why it was purchased or acquired) area. The assets identified in the chapter are accounted for in property accountability systems and financial accountability systems.

Land, other than Stewardship Land (discussed later), is defined as an asset with an identifiable cost that was specifically acquired for, or in connection with, the construction of General PP&E. General PP&E assets including facilities (buildings, structures, and utilities) must be recognized for accounting and reporting purposes. This includes the proper accounting treatment (expense or capitalization and depreciation) and the applicable depreciation amount on the Component's financial statements.

Let's look at the DoDFMR, Volume 4, Chapter 6.



Real Property (cont.)



According to the DoDFMR, Volume 4, Chapter 6, land is defined as the solid part of the surface of the earth. Excluded from the definition are natural resources such as depletable resources, mineral deposits and petroleum, for example, or renewable resources, such as timber and the outer continental shelf resources.



Version 1.0

Preparation for a Real Property Audit

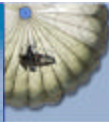
L1-5

According to this description found in the DoDFMR, Volume 4, Chapter 6, 060305, land is a fundamental component of real property. In fact, you might say it provides the grounds for all other real property! The Department controls approximately 30 million acres spread all around the globe. DoDFMR Volume 4, Chapter 6, is being updated.

The Land and Land Rights account is used to enter the recorded cost of land acquired by the Department. When the recorded cost can't be determined, the estimated fair market value is used.

Land is regarded as a non-wasting asset for accounting purposes and, therefore, not subject to depreciation. The recorded cost of land includes the purchase price, broker's commission, fees for examining and recording the title and surveying, and any razing and removal costs (less salvage proceeds) of structures on the land. Periodic payments by the Department for land rights are accounted for as an operating expense.

Let's talk about Heritage Assets.



Real Property (cont.)



Heritage Assets

- **Historical or natural significance**
- **Cultural, educational, or artistic importance**
- **Significant architectural characteristics**
- **Costs expended in period incurred**
- **Multi-use Heritage Assets' acquisition, betterment, or reconstruction are capitalized**



Version 1.0

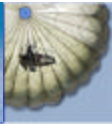
Preparation for a Real Property Audit

L1-6

Any land that is associated with Heritage Assets should also be included in the acreage cited in the Stewardship Land section of the financial statements. That is why I said a moment ago that land is either grouped into General PP&E Real Property or Stewardship Land. But just so we clearly understand them, Heritage Assets must have a historical or natural significance; a cultural, educational, or artistic importance; or significant architectural characteristics. The costs of acquiring Heritage Assets, and Stewardship Land for that matter, are expensed in the period incurred.

Some Heritage Assets are used both to remind us of our heritage and for day-to-day operations, like the White House and the Pentagon. These assets are referred to as Multi-use Heritage Assets. Unlike normal Heritage Assets, their recorded costs and any betterment or reconstruction costs are capitalized as General PP&E Real Property. An important point about Heritage Assets is that often you can't determine their cost or the cost is irrelevant to their significance. Like Stewardship Land, the government does not expect to use these assets to meet its obligations. The most relevant information about Heritage Assets is the non-financial descriptions such as acres of park forest. The public entrusts the government with these assets and expects their preservation.

Now let's take a closer look at Stewardship Land.



Real Property (cont.)



Stewardship Land is federally owned land:

- **Set aside for the use and enjoyment of present and future generations**
- **On which military bases are located**
- **Measured in non-financial units**
- **Not acquired for or in connection with General PP&E**



Version 1.0

Preparation for a Real Property Audit

L1-7

Stewardship Land is federally owned:

- land set aside for the use and enjoyment of present and future generations
- land on which military bases are located.

Except for military bases, this land is not used or held for use in general government operations. The government doesn't expect to use Stewardship Land to meet its obligations, unlike the assets listed on the Balance Sheets. It's measured in non-financial units, such as acres of land and lakes, miles of parkways, and miles of wild and scenic rivers.

Stewardship Land is not acquired for, or in connection with, General PP&E Real Property. The words "acquired for or in connection with" mean land acquired with the intent to construct General PP&E Real Property and land acquired in combination with General PP&E Real Property, including land used as the foundation and adjacent land considered to be common grounds. Without exception, all land provided to DoD from the public domain, or at no cost, is classified as Stewardship Land, regardless of how it's used. Therefore, public domain or donated/no-cost land used as General PP&E Real Property is classified as Stewardship Land, not as General PP&E land.



Real Property (cont.)



Inventory of Real Property

- **100% inventory at least every 5 years**
- **Reconcile physical inventory to property accountability records**



Version 1.0

Preparation for a Real Property Audit

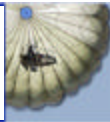
L1-8

You must do a 100 percent physical inventory of all real property at least every five years. The purpose of doing this physical inventory is to ensure that the Department's land is at the location identified in the property accountability records, as well as to verify who the PP&E custodian is and where the custodian is located. It further verifies the description and the condition as described in the property records. The inventory results are reconciled to the property accountability records with any differences researched and adjustments fully documented. Adjustments may be required for any unrecorded physical changes like removals, additions, or modifications that were not previously or properly recorded. Finally, the property accountability records should be reconciled to ensure proper recording in the financial statements.

In accordance with the DoDFMR, Volume 4, Chapter 6, 060107, C, PP&E assets not in use may be inventoried using statistical sampling.

When the physical identification or count is in error, you make adjustments to property accountability records. These adjustments must have supporting reports of survey (ROS) prepared in accordance with the DoDFMR, Volume 12, Chapter 7. Adjustments resulting from previously unrecorded modifications or alterations must have supporting documentation showing the costs of the changes. Adjustments to the General Ledger accounts, to record PP&E found during the inventory, are recorded under the appropriate Standard General Ledger (SGL) accounts for PP&E (1700 Series), or for losses, under "Other Losses" (SGL Account 7290).

Next we see what happens when we no longer need the asset.



Real Property (cont.)



Items that support an audit:

- **Placed-in-service date**
- **Useful life**
- **Disposal date**
- **Physical existence**
- **Supporting documentation**
- **Book cost**



One example is an earlier audit of the Army Corps of Engineers, where auditors found that sufficient controls were not in place to ensure the placed-in-service and disposal dates were supported or properly established. Why is that important?

The primary purpose of ensuring the accuracy of the disposal dates lies in the requirement to show depreciation over their useful lives. Additionally, the book costs of buildings and other structures must be supported by sufficient documentation. Accurate financial statements reporting requires assets to be recorded at full cost, including the costs to bring the asset to a form and location suitable for its intended use.

Can you think of other items an auditor may want to test? By anticipating the audit requirements and pre-validating information such as that shown on this slide, you can achieve an unqualified audit opinion.



Real Property (cont.)



DD Form 1354

Form Approved
OMB No. 0704-0186

PAGE OF **PAGE**

The public reporting burden for this collection of information is estimated to average 30 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, completing and reviewing the collection of information, sending comments regarding the burden estimate or other aspect of the collection of information, including suggestions for reducing the burden, and carrying out the required actions relating to the collection of information; send comments regarding this burden estimate or other aspect of the collection of information, including suggestions for reducing the burden, to Washington Headquarters Service, Paperwork Project Director (0704-0186). Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to any penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.

PLEASE DO NOT RETURN YOUR COMPLETED FORM TO THE ABOVE ORGANIZATION.

I. FRODO Investment Activity by Client and ZIP Code:

		F. DATE PREPARED (YYYYMMDD)		G. PROJECT/JOB NUMBER		H. SERIAL NUMBER (YYYYMMDD)		I. TRANSACTION DETAILS					
								a. NEW CONST. EXISTING FAC. CAPITAL IMP. OTHER (Specify)	b. PHYS. CON. AVAIL. RENT/ PATIAL R/O FINANCIAL CON. OTHER (Specify)				
S. TO (Investment Activity Service, ZIP Code & INDV)		T. SIPSERNO NAME		U. CONTRACT NUMBERS		V. DRAWING NUMBERS							
								G. DRAFT INTERIM	H. FINAL	J. EFFECTIVE DATE (YYYYMMDD)			

16 ITEM NO.		17 FACILITY NO.		18 CATEGORY CODE		19 CATCODE DESCRIPTION		20 TYPE		AREA UNIT OR MEAS 1		TOTAL QUANTITY UNIT 1		OTHER UNIT OR MEAS 2		TOTAL QUANTITY UNIT 2		16 COST		20 FUND SOURCE		21 FUND ORG		52 INTER EST CODE		23 ITEM REMARKS	

34. STATEMENT OF COMPLETION. The facilities listed herein are in accordance with plans, drawings, and specifications submitted to and approved by the authorized representative of the using agency except for the deficiencies listed on the reverse side.														35.a. ACCEPTED BY (Typed Name and Signature)														b. DATE SIGNED (YYYYMMDD)	
a. TITLED BY (Typed Name and Signature)										b. DATE SIGNED (YYYYMMDD)																		36. PROPERTY VOUCHER NUMBER	
c. TITLE (Use Proj.-Base Proj.-DPH)														e. TITLE (DPH/RFP)															

OD FORM 1354, MAR 2004

PREVIOUS EDITION IS OBSOLETE.

Revised

Version 1.0

Preparation for a Real Property Audit

L1-10

Looking at this DD Form 1354, Transfer and Acceptance of Military Real Property, you notice the top two rows are dedicated to information about the transfer-out and transfer-in activities. The third row describes the real property in detail, while the bottom of the form provides endorsement space. This form shows the essential information needed for the transfer and acceptance of military real property, and you should complete it to support entries into the real property accounts.

The Real Property Accountable Officer at the installation level usually prepares the DD Form 1354. An interim DD Form 1354 and the final DD Form 1354 is prepared in accordance with the Unified Facilities Criteria (UFC) 1-300-08. The installation needs this form when the real property is accepted.

When a service secretary determines that the property (except property designated as part of a Base Realignment and Closure (BRAC)) is excess to the needs of their Military Department, they may transfer it to another Military Department without reimbursement. If this isn't done, the Secretary of Defense (SECDEF) asks the General Services Administration (GSA) to transfer or dispose of it. Any proceeds generated from a transfer or disposal is deposited into a special fund Treasury Receipt account. Funds deposited into this account are then distributed back to the service by the OUSD(C) consistent with applicable appropriations acts.

Now let's examine real property buildings, structures, and facilities.



Real Property (cont.)



Accountability versus Capitalization

- **Accountability of property (threshold \$5,000)**
- **Capitalization of property (threshold \$100,000)**

When the Department acquires real property, the assets must be recognized for accounting and reporting purposes. Recognition requires that the proper accounting treatment (expense or capitalization and depreciation) and the reporting of the capitalized amounts and accumulated depreciation on the appropriate DoD Components financial statements. In most instances, the DoD Component that procures the asset, or the Component in possession of an asset, will be the Component that must account for and report the asset.

The DoD is required to maintain records of real property on both a quantitative and monetary basis. Volume 4, Chapter 6, of the DoDFMR establishes requirements for physical inventories of real property and requires DoD Components to inventory general real property at least every five years. The DoDFMR also details accounting standards and policies to meet its financial statement reporting requirements for real property.

When the tangible assets used by the entity have a useful life of at least two years and an initial cost that equals or exceeds the DoD capitalization threshold of \$100,000, they will be capitalized. These assets, except for land, will be capitalized and depreciated in accordance with Volume 4, Chapter 6, Table 6-7 and reported on the Components financial statements.

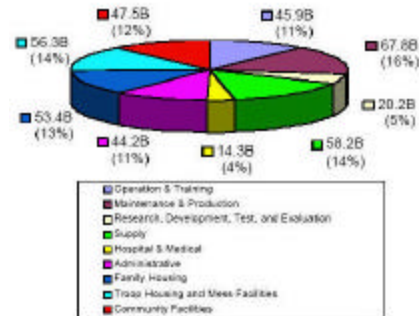


Buildings, Structures, and Facilities



Buildings, structures, and facilities include fences, roads, bridges, sewers and other utilities, ship and railroad wharves and docks, dry docks, fuel storage facilities, hangars, warehouses, and air traffic control towers.

**Real Property in use by DoD
(in billions of dollars)**



Source: DoD Base Structure Report, 2004 Baseline

Version 1.0

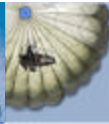
Preparation for a Real Property Audit

L1-12

We discussed earlier that real property includes things on land or attached to land. A building is a fully enclosed space that people can occupy and has environmental controls. Structures are something constructed, but they don't have to be buildings; and facilities are something created to serve a particular function. Real property structures include fences, roads, bridges, towers, wharves and docks, and fuel storage facilities. So in reality, this category covers everything built on or in the ground.

The Department's real property holdings are absolutely huge, consisting of more than 600,000 buildings, structures, and facilities, located at more than 4,700 locations, on approximately 30 million acres. This graph shows the replacement value in billions of dollars for the various types of real property in use. Sites range in size from small, unoccupied locations supporting a single navigational aid on less than one-half acre, to the Navy's complex of installations at Norfolk, Virginia with more than 78,000 employees, and to the Air Force's Nellis Air Force Range in Nevada or the Army's White Sands Missile Range in New Mexico, each with over 3 million acres. After seeing this abundance of real property, you understand the range of targets for auditors to seek out.

Let's see more.



Buildings, Structures, and Facilities (cont.)



Leased Real Property



Leasehold improvements are the value of capitalized improvements to leased property. When leasehold improvements equal or exceed the DoD capitalization criteria, such improvements shall be capitalized and amortized.



Version 1.0

Preparation for a Real Property Audit

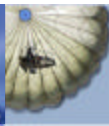
L1-13

Real property assets include those acquired through capital leases, including leasehold improvements. Leasehold improvements are the value of capitalized improvements to leased property. When leasehold improvements meet or exceed the DoD capitalization criteria, such improvements shall be capitalized and amortized.

A capital lease is one that transfers most all the benefits and risks of ownership to the lessee. If at the beginning of a lease it meets one or more of the following four criteria, it should be classified as a capital lease.

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executor cost, equals or exceeds 90 percent of the fair value of the leased property.
- The Army and Air Force have 801 Family Housing Capital Leases.

Otherwise, it should be classified as an operating lease and expensed. The last two criteria are not applicable when the beginning of the lease term falls within the last quarter of the economic life of the property. The economic life can be ascertained by examining the depreciation schedule found in the DoDFMR, Volume 4, Chapter 6, Table 6-7.

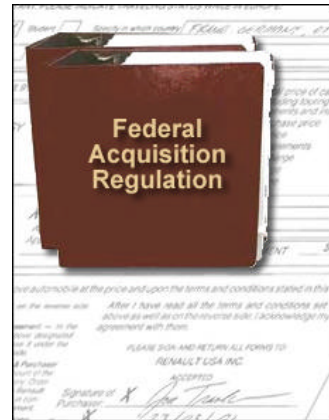


Buildings, Structures, and Facilities (cont.)



FAR 45 implications for property in the possession of contractors:

- **Contractors must keep official property records**
- **Only one official set of records maintained**
- **Review and approval of contractor's property control system**



<http://www.arnet.gov/far/>

Version 1.0

Preparation for a Real Property Audit

L1-14

Normally, contractors furnish all property necessary to perform government contracts, but if they must possess government property, they must be responsible and accountable for it. They are to keep the government's official records of the property in their possession or control; however, contracts may provide for the contracting office to maintain the government's official property records. We will discuss additional guidance when reviewing the DoDFMR in a few minutes.

Contractors in possession of government property must also abide by the Federal Acquisition Regulation (FAR) property accountability requirements. Specifically, Part 45 prescribes policies and procedures for providing government property to contractors, their use and management of government property, and reporting, redistributing, and disposing of contractor inventory. While the details of the FAR are beyond the scope of this course, there are a few areas you should be aware of.

An important part of the process is the review and approval of a contractor's property control system to ensure compliance with the government property clauses of the contract. It is accomplished by the agency responsible for contract administration either by the contracting officer or the responsible property administrator. When the property administrator notifies the contractor that its property control system doesn't comply with the FAR, the contractor must correct deficiencies. If the contractor does not correct the deficiencies within a reasonable period, the property administrator requests action by the contracting officer who then notifies the contractor in writing of any required corrections and establishes a schedule for completion of actions. The contractor is cautioned that failure to take the required corrective actions within the time specified will result in withholding or withdrawing system approval and that its liability for loss of or damage to government property may increase if approval is withheld or withdrawn.



Buildings, Structures, and Facilities (cont.)



Accounting for property, plant, and equipment
Federal Financial Accounting Standards no. 6

Federal Accounting Standards Advisory Board
(FASAB)

ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards No. 6

Version 1.0

Preparation for a Real Property Audit

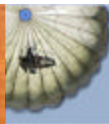
L1-15

This statement contains accounting standards for Federally owned property, plant, and equipment (PP&E); deferred maintenance on PP&E, and cleanup costs. PP&E is defined as follows: tangible assets that (1) have an estimated useful life of two or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used by the entity. General PP&E includes land acquired for or in connection with other general PP&E.

General PP&E shall be reported on the basic financial statements: the Balance Sheet, and the Statement of Net Cost. The acquisition cost of the general PP&E shall be recognized as an asset. Subsequently, except for land which is a non-depreciable asset, that acquisition cost shall be charged to expense through depreciation. The depreciation expense shall be accumulated in a contra asset account – accumulated depreciation.

General PP&E also includes assets acquired through capital leases, including leasehold improvements; property owned by the reporting entity in the hands of others such as state and local governments, colleges and universities, or federal contractors.

Now let's discuss capital improvements.



Capital Improvements



Capital improvements, as stated in FASAB, SFFAS No. 6, identify costs that either extend the useful life of an existing asset or enlarge or improve its capacity shall be capitalized and depreciated over the remaining useful life of the asset. In the current DoD real property management environment, there may be various interpretations of the criteria to account for the costs to improve an asset as a capital improvement.



Version 1.0

Preparation for a Real Property Audit

L1-16

Some sources use the term betterment rather than improvement, but they contain the same meaning. Also, an improvement is distinguished from repair or maintenance by the fact that repair or maintenance merely keeps the asset in its customary state of operating efficiency without expecting any additional future benefits. Improvements to General PP&E Real Property (including Multi-use Heritage Assets) that equal or exceed the DoD capitalization threshold of \$100,000 are individually capitalized within real property systems and depreciated over the applicable DoD standard recovery period. For example, improvements to fences, roads, bridges, sewers, and other utilities are depreciated over 10 years, and improvements to buildings and other structures are depreciated over 20 years.

Maintenance and repair costs are not considered capitalized improvements, regardless of whether the costs equal or exceed the Department's capitalization threshold. Also, a facility may be repaired by replacement and the replacement can involve upgrading to current standards and codes. For example, a roof can be repaired by replacement using a better quality and longer life shingle that meets current building codes.

If you modify functionality, such as making office space into a gym, that is a capital improvement. If the building is modified as a larger building, or perhaps the building is reconstructed with energy saving features that lower its operating costs, and these costs meet the capitalization threshold, the improvement is capitalized. This is true for General Funds and WCF.



Capital Improvements (cont.)



Unit Cost of Improvements



Version 1.0

Preparation for a Real Property Audit

L1-17

The cost of improvements to more than one General PP&E Real Property asset completed under a single contract that cannot be specifically identified by asset is capitalized only if the allocated cost per asset equals or exceeds the capitalization threshold.

For example, if a contractor is paid \$200,000 under one contract to replace the air conditioning units in 10 buildings with more efficient air conditioning units, the cost per building is \$20,000. Since \$20,000 is below the capitalization threshold of \$100,000, it would not be capitalized. However, if \$200,000 was paid for two buildings, the amount would be capitalized because the threshold would have been met as each building's cost would be \$100,000.

Another example occurs when more than one improvement is made to a single building, facility, or structure, and the improvements are part of a single overall effort to increase the facility's capacity, size, or useful life. In this instance, the sum of the costs of the improvements are capitalized even if the efforts are funded separately. For example, assume three separate contracts are created to improve a building. One contract modifies the exterior of the building for \$90,000, the second contract modifies the interior of the facility for \$200,000, and a third contract replaces the heating and air conditioning system for \$35,000. The total of three improvements (\$325,000) is capitalized, since the three individual projects are part of a single effort to improve the building.

Now let's look at some terms you may not be familiar with.



Capital Improvements (cont.)



Define:

- Recognition
- Capitalization
- Depreciation

Department of Defense Agency Wide CONSOLIDATED BALANCE SHEET As of September 30, 2004 and 2003 (\$ in Millions)		
	2004 Consolidated	2003 Consolidated Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 287,685.5	\$ 251,544.1
Non-Entity Seized Iraqi Cash	113.4	278.1
Non-Entity-Other	1,800.0	239.8
Investments (Note 4)	231,069.7	205,376.0
Accounts Receivable (Note 5)	1,118.3	1,066.6
Other Assets (Note 6)	1,011.9	105.0
Total Intragovernmental Assets	\$ 522,798.8	\$ 458,609.6
Cash and Other Monetary Assets (Note 7)	\$ 2,178.1	\$ 1,534.9
Accounts Receivable (Note 5)	7,427.8	7,299.9
Loans Receivable (Note 8)	70.7	64.0
Inventory and Related Property (Note 9)	219,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
Investments (Note 4)	406.5	217.8
Other Assets (Note 6)	21,486.3	21,729.6
TOTAL ASSETS	\$ 1,208,486.2	\$ 1,141,309.3

Version 1.0

Preparation for a Real Property Audit

L1-18

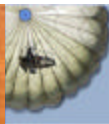
Here we have three terms that are important to support your understanding of real property and the financial statements.

The first, recognition, is the process of formally recording an item into the financial statements as an asset, liability, revenue, expense, or the like. Generally you hear this term in reference to a determination of which entity is responsible for recording and reporting an accounting event. For example, when two entities are involved in a transaction, both entities must recognize the transaction.

Capitalization of an asset means recording it as an asset on the Balance Sheet and carrying any subsequent benefits forward into future periods where they are then realized. You may remember that at its inception, DFAS capitalized the assets that the services had previously recognized. Here, on this 2004 Consolidated Balance Sheet, the net amount of General PP&E Real Property capitalized by the Department is circled.

The term "net amount of General PP&E" is often used because this amount includes depreciation. Depreciation is the allocating of the cost of an asset over its useful life. Depreciation expenses shall be calculated and accumulated using the straight-line method based on the recorded cost less any salvage value, and divided equally among accounting periods during the asset's useful life, based on recovery periods in Table 6-7 of Volume 4, Chapter 6 of the DoDFMR. Therefore, the initial capitalized cost, less the total amount depreciated, is the net book value or net amount of capitalized assets.

In the next topic, we will look at some of the related guidance, particularly those related to capital thresholds.



Standards and Guidance



Real property standards and guidance:

- **Statements of Federal Financial Accounting Standards (SFFAS)**
- **Department of Defense Financial Management Regulation (DoDFMR)**
- **DoD Directive 4165.6, Real Property**
- **DoD Instruction 5000.64, Defense Property Accountability**
- **Executive Order 13327, Federal Real Property Asset Management**



Version 1.0

Preparation for a Real Property Audit

L1-19

Here are the primary sources of standards and guidance associated with real property:

- SFFAS issued by the Federal Accounting Standards Advisory Board (FASAB)
- DoD Financial Management Regulation (DoDFMR)
- DoD Directive (DoDD) 4165.6, Real Property
- DoD Instruction (DoDI) 5000.64, Defense Property Accountability
- Executive Order 13327, Federal Real Property Asset Management.



Standards and Guidance (cont.)



Statements of Federal Financial Accounting Standards (SFFAS)

- **Establish federal generally accepted accounting principles (GAAP)**
- **GAAP language communicates outside government**
- **Help determining government's accountability, efficiency, and effectiveness**

Version 1.0

Preparation for a Real Property Audit

L1-20

Let's begin by developing an understanding of what standards we are talking about.

The Chief Financial Officers Act (CFOA) requires audited financial statements in accordance with "applicable standards." The FASAB was established to develop federal accounting standards from financial statements therefore fulfilling the law. The Board includes the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General who develop standards for the financial statements. The SFFAS issued by the FASAB are designed to implement the Generally Accepted Accounting Principles (GAAP).

Why is GAAP so important? The Comptroller General described the GAAP as being like the Good Housekeeping Seal of Approval. He stated that it is "language that communicates outside of government and is increasingly important as more private business practices are incorporated into Government." FASAB (and therefore GAAP) lends additional credibility to the audited financial statements.

According to the FASAB website, the federal accounting standards and financial reporting play a major role in fulfilling the government's duty to be publicly accountable and can be used to assess (1) the government's accountability and its efficiency and effectiveness, and (2) the economic, political, and social consequences of the allocation and various uses of federal resources.

Next, we will examine the capitalization threshold for components of real property.



Standards and Guidance (cont.)



**Capitalization guidance is provided in SFFAS No. 6,
Accounting for Property, Plant, and Equipment.**



You want the threshold set at what?

Version 1.0

Preparation for a Real Property Audit

L1-21

SFFAS No. 6 states that capitalization thresholds should be established by the individual federal entities rather than centrally by the Board. The reason for this is that federal entities are diverse and must consider their own financial and operational conditions in establishing an appropriate capitalization threshold.

Instead of setting a specific threshold, the Board adopted a materiality approach as is done in private sector accounting. Each agency establishes its own threshold and applications guidance for the threshold to bulk purchases.

The Board believes that permitting management discretion in establishing capitalization policies leads to a more cost-effective application of the accounting standards.

Once established, the threshold should be consistently followed and disclosed in the entity's financial reports.



Standards and Guidance (cont.)



The DoD capitalization guidance was updated based on SFFAS No. 23, Eliminating the Category National Defense Property, Plant, and Equipment.



Version 1.0

Preparation for a Real Property Audit

L1-22

SFFAS No. 23 eliminated the category National Defense PP&E (ND PP&E) and reclassified its items to the General PP&E Real Property category. Initial capitalization amounts for assets previously considered ND PP&E are now based on historical costs, including any major improvements or modifications. It's understood that determining initial historical cost is difficult or even impossible for some items acquired many years ago when historical records were not required to be retained. So when initial historical costs can't be practically obtained, estimated historical costs are used.

Other information may also be used as the basis for estimating historical cost such as budget, appropriation, or engineering documents and other reports reflecting amounts expended. Another alternative is to use estimates of historical costs by taking the current replacement costs of similar items and then deflating them through use of price-level indexes to the actual or estimated acquisition year.

Finally, don't forget that accumulated depreciation should be calculated.

Let's see what the DoDFMR has to say about capitalization.



Standards and Guidance (cont.)



The DoD capitalization threshold is \$100,000.

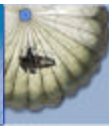
- **Two or more years useful life**
- **Not intended for sale**
- **Intended for use**
- **Meet threshold**



The DoDFMR states that General PP&E, including real property, consists of tangible assets with an estimated useful life of two or more years. It must also not be intended for sale as a part of normal operations. The property must be acquired or constructed with the intention of being used or available by the entity, and have an initial recorded cost that equals or exceeds the capitalization threshold. The capitalized threshold has been \$100,000 for both General and Working Capital Funds since FY1996; however, the accountability threshold is \$5,000.

The capitalization threshold was \$15,000, \$25,000, and \$50,000 for FYs 1993, 1994, and 1995. Any real property capitalized from these years remains capitalized and subject to depreciation for WCF activities. For General Fund activities, if the cost is less than \$100,000, it should have already been written off as a prior period adjustment in FY 1998. This means that you are no longer required to capitalize or depreciate it. In addition to the initial recorded cost, other costs to bring it to an operable condition are capitalized if the total cost is equal to or greater than the threshold and the asset has an estimated useful life of two or more years. If the recorded costs, including other costs needed to bring the asset to an operable condition, are less than the capitalization threshold, the costs are expensed. The costs of acquiring Heritage Assets and Stewardship Land are always expensed in the period incurred.

The DoDFMR also speaks about certain special cases. Let's look at a few now.



Standards and Guidance (cont.)



The Corps of Engineers' Civil Works capitalization threshold is \$25,000, while buildings and structures related to hydropower projects are capitalized regardless of cost.

**EC 405-1-02, Real Estate
Project Inventory
Management, Accountability,
and Documentation**



<http://www.hq.usace.army.mil/cere/ARs/EC%20405-1-02.doc>

Version 1.0

Preparation for a Real Property Audit

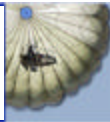
L1-24

USACE has its own guidelines for real property capitalization treatment outlined in Chapter 16 of the EC 405-1-02. They are capitalized at historical recorded cost plus any capitalized improvements when the asset has a useful life of two or more years and an recorded cost of more than \$25,000. As always, there's an exception. In this case, all buildings and structures related to hydropower projects are capitalized, regardless of cost.

It is important to stay current because policies and directives are constantly being updated. For example, during 2003, the Corps increased its buildings and structures capitalization threshold from \$0 to \$25K for all Civil Works appropriations with the exception of revolving fund and Power Marketing Agency (PMA) assets.

All Civil Works buildings and structures currently capitalized under \$25,000 (excluding Revolving Fund and PMA) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System (CEFMS). Beginning in FY 2004, all Civil Works buildings and structures under \$25,000 are expensed, except for PMA assets.

Let's look at some other special capitalization rules that aren't USACE related.



Standards and Guidance (cont.)



Property in Possession of Contractors per DoDFMR and FAR



Version 1.0

Preparation for a Real Property Audit

L1-25

When property in the possession of contractors meets the Department's capitalization threshold, it is reported on the Balance Sheet. The Department is developing new policies and a contractor reporting process that provides appropriate General PP&E Real Property information for its financial statements in order to move closer to compliance with federal accounting standards. As we saw in our earlier discussion of the FAR, the accountability process can vary from contract to contract – depending on how each contract is written. The Department has guidance that requires the components to maintain, in their property systems, detailed information on property provided to contractors, including real property and DoD property transferred from one contract to another contract. DoD property that was procured or fabricated by a contractor is accounted for and reported by the contractor, until the property is recorded in DoD property accountability records or systems.

This picture shows an Army ammunition plant which is a Government-Owned Contractor-Operated (GOCO) facility.

Next we review some of the Department's policy on real property.



Standards and Guidance (cont.)



Executive Order 13327, Federal Real Property Asset Management, 2/6/2004

DoD Directive 4165.6, Real Property, 10/13/2004

DoDI 5000.64, Defense Property Accountability



http://www.archives.gov/federal_register/executive_orders/2004.html
<http://west.dtic.mil/whs/directives/corres/dir1.html>

Version 1.0

Preparation for a Real Property Audit

L1-26

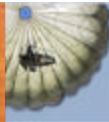
Previously, you may have become familiar with the DoD Directives 4165.6, 4165.12, and 4165.16 – all associated with real property. They are now cancelled and these are the new requirements.

EO 13327 promotes the efficient and economical use of America's real property assets. This EO emphasizes management accountability for implementing federal real property management reforms. It also orders executive agencies to recognize the importance of real property resources through increased management attention, the establishment of clear goals and objectives, improved policies and levels of accountability, and other appropriate actions. One of the more important aspects of EO 13327 is the requirement to designate a senior real property officer responsible for the development and implementation of an asset management planning process.

This is the new DoDD 4165.6, Real Property, is in place. This directive provides Department policy on the acquisition, management, and disposal of real property consistent with Executive Order (EO) 13327. The Directive emphasizes the synergistic policy of the Department whereby each military department meets its own real property requirements, while simultaneously advancing the mission of the DoD.

DoDI 5000.64 provides a comprehensive framework for the Department's property accountability policies, procedures, and practices. It assists DoD property managers, accounting and financial officers, and other officials in understanding their roles and responsibilities relating to property accountability.

Let's look at the information on the financial statements.



Validating Reporting of Statements and Checklist Integrity



Validating Financial Statement Assertions

- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations**
- **Valuation or Allocation**
- **Presentation and Disclosure**



Version 1.0

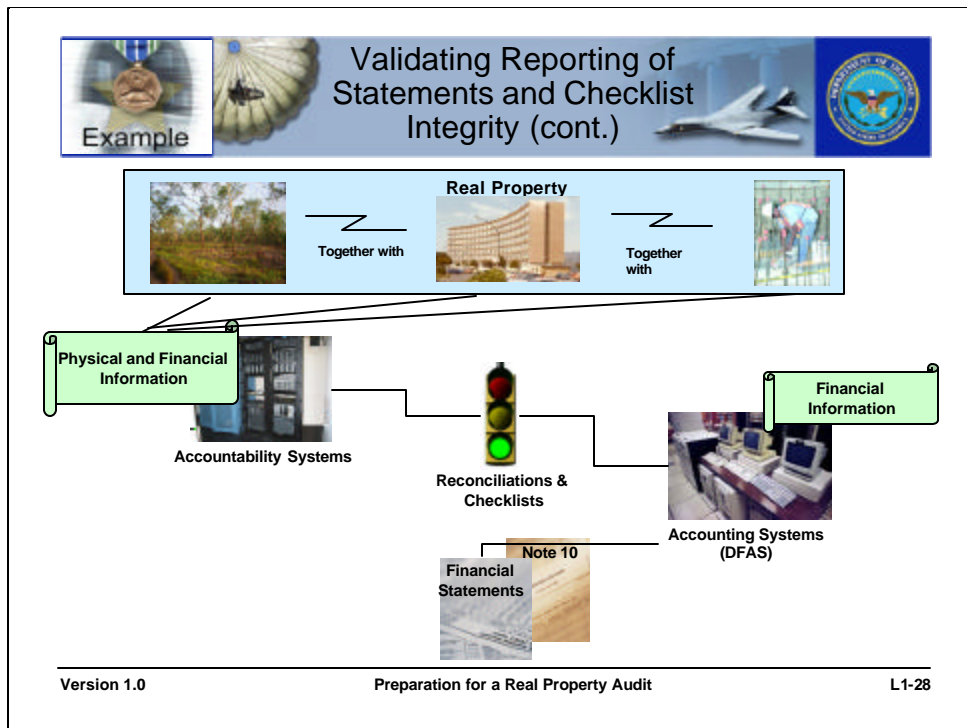
Preparation for a Real Property Audit

L1-27

An audit of the financial statements requires the auditors to express an opinion as to whether the statements are presented in conformity with government auditing standards. The auditors' objectives in examining real property are to obtain evidence that the PP&E, Real Property exists, that it includes all amounts that should be recognized, and that the amounts are appropriate.

In this part of the lesson, we examine the act of validating the accuracy and completeness of the data on the financial statements, and we illustrate ways of testing for truth by using checklists.

Let's start by looking at the sequence of events that leads to figures accumulating on the financial statements.



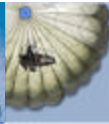
We begin by noting the accountability of real property (land, buildings, structures, and facilities), as well as capital improvements by asset.

At this point, we are concerned with physical information such as acres or square feet.

This is followed by entry of dollar values which must be reconciled with the accounting information to ensure the integrity of financial information.

One part of this process is a physical inventory to assure periodic, independent verification of the accuracy of both the accountability records and accounting records, and reconciliation of subsidiary property accountability records to the general ledger accounts.

The products include financial statements that reflect the accumulated operations for your agency and, ultimately, the Department.



Validating Reporting of Statements and Checklist Integrity (cont.)



General Ledger Accounts

ACCOUNT NO. 1720	
Construction on Property	
DESCRIPTION: Includes costs of direct labor, direct material and overhead incurred in the construction of PP&E. Upon completion, these costs will be transferred to the proper capital asset account as the acquisition cost of the item.	
DEBIT	CREDIT
1. To record the costs of construction still in progress. Counts: 2110, 6100	1. To transfer completed projects to property accounts. Counts: 1712, 1730, 1740
NORMAL BALANCE Debit	

FIGURE 6-4

ACCOUNT NO. 1740	
Other Structures and Facilities	
DESCRIPTION: The cost of government-owned structures and facilities, other than buildings, that are under the control of a DoD Component.	
DEBIT	CREDIT
1. To record acquisition cost of other structures and facilities. Counts: 2110, 1720	1. To write off fully depreciated structures and facilities. Counts: 1740
2. To record transferee's acquisition cost of facilities received without reimbursement. Counts: 1740, 1720	2. To record the value of structures and facilities transferred out without reimbursement. Counts: 1740, 1720
NORMAL BALANCE Debit	

FIGURE 6-7

Version 1.0

Preparation for a Real Property Audit

L1-29

US Standard General Ledger Account 1720 is the CIP, which identifies dollars transferred from the USACE or the NAVFAC on an annual basis and is used to record the costs of CIP. This will show up on Note 10, under the Major Asset class.

US Standard General Ledger Account 1740 is the Other Structures and Facilities, which will show the account to be debited to record the acquisition costs of Other Structures and Facilities received or purchased by a DoD Component. This will show up on the Balance Sheet, or more specifically, on Note 10 under the Major Asset class.



Validating Reporting of Statements and Checklist Integrity (cont.)



Note 10

Balance Sheet

Note 10. General PP&E, Net						
As of September 30	Depreciation Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,653.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Improvements	S/L	10	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction- in Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	(\$ 947,711.7)	\$ 440,898.6	\$ 458,308.9

Department of Defense Agency Wide CONSOLIDATED BALANCE SHEET As of September 30, 2004 and 2003 (\$ in Millions)			
	2004 Consolidated	2003 Consolidated Restated	
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	\$ 287,885.5	\$ 251,544.1	
Non-Entity Seized Iraqi Cash	113.4	278.1	
Non-Entity-Other	1,880.0	239.8	
Investments (Note 4)	231,089.7	285,316.0	
Accounts Receivable (Note 5)	1,118.3	1,066.6	
Other Assets (Note 6)	1,011.9	105.0	
Total Intragovernmental Assets	\$ 522,798.8	\$ 458,609.6	
Cash and Other Monetary Assets (Note 7)	2,178.1	1,534.9	
Accounts Receivable (Note 8)	7,427.8	7,299.9	
Loans Receivable (Note 9)	70.7	64.0	
Inventory and Related Property (Note 10)	313,742.4	305,544.6	
General Property, Plant and Equipment (Note 11)	440,898.6	458,308.9	
Investments (Note 12)	89.5	207.2	
Other Assets (Note 13)	21,486.3	21,729.6	
TOTAL ASSETS	\$ 1,208,489.2	\$ 1,141,309.3	
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	\$ 1,888.4	\$ 101.4	
Debt (Note 13)	591.8	688.2	

PAR: <http://www.dod.mil/comptroller/financialindex.html>

Version 1.0

Preparation for a Real Property Audit

L1-30

The Department's financial information is composed of the principal financial statements, notes to these statements, consolidating and combining statements, and other required information. Since we are concerned with assets, or things owned by the Department, we are mostly concerned with the Balance Sheet. The Balance Sheet reflects assets, liabilities, and the difference between assets and liabilities called net position.

This slide depicts several important points about how real property is reported by the Department. A portion of the Balance Sheet is shown on the right half of this slide with 2003 data in the far right column and 2004 data in the next column – from right to left. Notice that General PP&E is circled in both columns and a calculation of their difference reveals approximately a one percent decrease.

Although financial statements fluctuations greater than 10 percent are generally explained within the notes to the financial statements, any change that is determined material is also explained.



Validating Reporting of Statements and Checklist Integrity (cont.)



Note 10

Balance Sheet

Note 10. General PP&E, Net							Department of Defense Agency Wide CONSOLIDATED BALANCE SHEET As of September 30, 2004 and 2003 (\$ in Millions)	
As of September 30	Depreciation Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value	2004 Consolidated	2003 Consolidated Restated
(Amounts in millions)								
1. Major Asset Classes:								
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4		
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,388.0		
C. Leasehold Improvements	S/L	10	139.1	(96.3)	42.8	96.2		
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7		
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2		
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0		
G. Assets Under Capital Lease	S/L	lease term	585.9	(379.2)	206.7	233.6		
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3		
I. Other			63.1	(3.1)	60.0	92.5		
J. Total General PP&E			\$ 1,389,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9		
* See Note 15 on Capital Lease Liability for additional information								
S/L = Straight Line N/A = Not Applicable								

ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)		\$ 267,885.5	\$ 251,544.1
Entity		113.4	278.1
Non-Entity Seized Iraqi Cash		1,800.0	238.9
Non-Entity-Other		231,069.7	205,376.0
Investments (Note 4)		1,119.3	1,086.6
Accounts Receivable (Note 5)		1,011.9	105.0
Other Assets (Note 6)		\$ 522,788.8	\$ 498,609.6
Total Intragovernmental Assets			
Cash and Other Monetary Assets (Note 7)		\$ 2,178.1	\$ 1,534.9
Accounts Receivable (Note 8)		7,427.8	7,299.9
Loans Receivable (Note 9)		70.7	64.0
Inventory and Related Property (Note 10)		213,719.4	205,544.6
General Property, Plant and Equipment (Note 11)		440,898.6	446,308.9
Investments (Note 12)		48.5	227.7
Other Assets (Note 13)		21,486.3	21,729.6
TOTAL ASSETS		\$ 1,258,492.2	\$ 1,141,309.3
LIABILITIES (Note 14)			
Intragovernmental:			
Accounts Payable (Note 15)		\$ 1,888.4	\$ 101.4
Debt (Note 16)		591.8	699.2

PAR: <http://www.dod.mil/comptroller/financialindex.html>

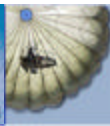
Version 1.0

Preparation for a Real Property Audit

L1-31

That said, if you follow the arrowed line from the Balance Sheet to Note 10 on the left side of the slide, you see that the General PP&E amount is shown in great detail. It is broken into the Major Asset Classes of Land; Buildings, Structures, and Facilities; Leasehold Improvements; Software; General Equipment; and so on down the left side. A dotted line surrounds the detailed information for Buildings, Structures, and Facilities while Land is just above the dotted box. Assuming you knew nothing about this statement, what immediate information might you develop from viewing Note 10 for Land and Buildings? Notice the increase in Land from 2003 to 2004. As there is no depreciation for land, an increase is likely from acquisition. The Buildings, Structures, and Facilities line decreased from 2003 to 2004 and is difficult to determine without more information. The actual notes state the decrease of \$8.4 billion or 11 percent was primarily due to an error in Navy General Fund data captured for FY 2003 accumulated depreciation. This error was corrected in FY 2004.

A few other points to view on the Notes page include the columns for Depreciation/Amortization, Service Life, Acquisition Value, Depreciation, and Net Book Value. The Department's statements and other relevant information can be found in the Performance and Accountability Report (PAR).



Validating Reporting of Statements and Checklist Integrity (cont.)



Reporting 1050 – Checklist for Federal Accounting, Reporting, and Disclosures		
Section III		
Balance Sheet		
Assets	Yes, No or N/A	Explanation
General Property, Plant, & Equipment (Net) (187–233)		
<i>General property, plant, and equipment (PP&E) are any property, plant, and equipment used in providing goods or services. (SFFAS 6, par. 23)</i>		
187. Has the entity established, disclosed, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (SFFAS 6, par. 13)		
188. Does the entity follow a policy that ensures its PP&E consists of tangible assets, including land, that meet the following criteria? a. have estimated useful lives of 2 years or more b. are not intended for sale in the ordinary course of operations c. are acquired or constructed with the intention of being used or being available for use by the entity (SFFAS 6, par. 17)		
189. Does PP&E consist of the following items?		

GAO/PCIE FAM: <http://www.gao.gov/special.pubs/gaopcie/>

Version 1.0

Preparation for a Real Property Audit

L1-32

How can you know the information in the Balance Sheet fairly represents the actual assets held?

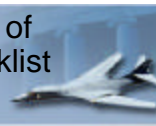
There are several answers to that question, but the answer is partly contained in checklists. For example, in our effort to verify the amount shown in the Balance Sheet, we would want to use checklists from the Government Accountability Office/President's Council on Integrity and Efficiency (GAO/PCIE) Financial Audit Manual (FAM).

The Balance Sheet General PP&E Real Property questions are found in Section III, Questions 187-233 of the Checklist for Federal Accounting, Reporting, and Disclosures. The Checklist for Federal Accounting, Reporting, and Disclosures, is shown in Appendix B. A review of these questions provides significant insight into what the auditor will be doing during the visit.

Notice the first question regarding capitalization thresholds. The question also provides a reference, SFFAS 6, but you may recall from our earlier discussion that the SFFAS doesn't provide a specific dollar threshold; it only indicates that the individual entities will establish their own. So we would want to add our own reference, which would include the DoDFMR, Volume 4, Chapter 6. Individual agencies can create their own checklists that provide additional details; however, the GAO/PCIE FAM checklist is a good basis to ensure that your checklist covers all pertinent areas.



Validating Reporting of Statements and Checklist Integrity (cont.)



5 Phases of the Business Rules

Discovery and Correction	Validation	Assertion	Assessment	Audit
WHY <ul style="list-style-type: none">Discover problemsEvaluate solutionsPlan solutionsCorrect processesComplete policyComplement BMMF HOW <ul style="list-style-type: none">Develop improvement plansEstablish audit committeesDevelop systems strategyPrepare business cases for systems changesPrepare and review full set of financial statements each quarter	WHY <ul style="list-style-type: none">Enhance credibility of assertions HOW <ul style="list-style-type: none">At beginning, coordinate and obtain comment from DoDIG and notify RPSManagement documents processes, identifies controls & systems, and ensures auditable universe of transactions & supporting documentation is availableManagement requests validation of financial informationPerformed by internal review, component's audit agencies, or external audit firm	WHY <ul style="list-style-type: none">Communicate to DoDIG and auditors reliability of financial information HOW <ul style="list-style-type: none">Assertion letter to DoDIG that:<ol style="list-style-type: none">Responds to DoDIG's instructionsIncludes checklistIncludes results of validation and reportsEngagement letter and management representative letter, if usedMemo to DoDIG, copy to OUSD (C) RPSESC approval for assessment/audit	WHY <ul style="list-style-type: none">Allows remediationAttests to management assertionPlan auditReduce risk of unknowns (auditor)Introduction to organization (auditors) HOW <ul style="list-style-type: none">DoDIG oversight of IPAsDoDIG in-house	WHY <ul style="list-style-type: none">Implement CFO ActImplement 1008Presidents' Management Agenda HOW <ul style="list-style-type: none">Pass assessmentDoDIG oversight of IPAs

Version 1.0

Preparation for a Real Property Audit

L1-33

In an effort to ensure the integrity of the Department's financial statements, the Comptroller's memo of June 23, 2004, established business rules that all components are required to follow. They provide a framework to move the Department towards an unqualified audit opinion. The memo provides guidance, as well as a sample management assertion and checklist. The business rules describe the oversight process the Department established to ensure that the corrections described in component plans are implemented and validated. They consist of five major phases. Each phase has a specific function that requires management's attention. The phases are:

- Discovery and Correction
- Validation
- Assertion
- Assessment
- Audit.

The Discovery and Correction Phase is when you identify and correct deficiencies and plan how to prevent them from recurring. The Validation Phase validates the corrections made and enhances the credibility of the assertions. The Assertion Phase is when you state that you are ready for an audit. It signifies that management has designated staff to work with the auditors and that documentation has been reviewed and is available to support the audit. This is accomplished by submission of the Assertion Package – reference the OUSD(C) memo dated November 14, 2004. The Assessment Phase attests to the management assertion for the preparation of the audit.

If everything is approved, then the audit is scheduled. The audit provides visibility of the status of real property assets and liabilities, costs, and internal controls. The checklist itself can be started during the Discovery and Correction Phase, but its primary purpose is to assist you in performing the Assessment Phase. It's designed to prepare you for financial statement audits by providing information that is typically needed.

Let's review a few of the checklist items.



Validating Reporting of Statements and Checklist Integrity (cont.)



Financial Improvement Initiative Business Rules – Checklist

CHECKLIST

When performing corrective action validation and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.

This checklist is designed to help components prepare for audits by providing the information that is typically needed for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditors in the form of a "Prepared By Client (PBC) List."

The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in validating that these steps have been completed.

- ☐ 1 Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that makes up the balance(s) being asserted as ready for audit.
- ☐ 2 Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.
- ☐ 3 Have all other supporting information that supports the balance(s) being asserted.

Version 1.0

Preparation for a Real Property Audit

L1-34

Refer to Appendix C in your Student Guide. There are 18 steps on the checklist and they range from the quick and easy to very difficult. For example, Step 7 asks you to compile an organization chart showing the key persons. On the other hand, look at Step 2. Getting all the general ledger transaction detail and supporting real property information from feeder systems isn't something you can run out and do the day the auditors are scheduled to arrive. It requires planning and coordination.

Step 3 on the checklist brings up another important point. This step says to consolidate evidential matter that supports the transactions in Step 2 or map where it is located, so you can find and retrieve it quickly and easily. As an example, DFAS uses a folder process to gather documentation and to be prepared to make it easier for answering the auditors on questions of their financial statements. The method of estimation and all the details are important documentation that support the cost estimate. There are certain acceptable procedures for valuing PP&E for which historical cost documentation does not exist. These include:

- current working estimates prepared for acquisition, appropriation, or other Congressional information
- Plant Replacement and Improvement Program documentation
- development of an estimate based on the cost of similar assets at the time of original acquisition
- current cost of similar assets discounted for inflation since the time of acquisition.

The effort put forth and the precision desired should be relative to the value and significance on the specific asset involved.



Validating Reporting of Statements and Checklist Integrity (cont.)



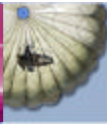
The DoDFMR states that a key test of the adequacy of an audit trail is whether tracing the transaction forward or backward will permit verification of the amount recorded or reported.

Source: FMR Volume 1, Chapter 8, Key Accounting Requirement Number 8

The link that ties the financial statements to the originating documentation or input is called the audit trail, and it must be traceable. This is an important concept because the audit trail documents the processing of source transactions into feeder systems and through the accounting system, as reflected in the financial statements. The DoDFMR says an audit trail enables the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source.

The audit trail is established with purchases, transfers, donations, or other acquisitions and becomes effective on the date that the DoD component takes custody of the PP&E. Retirements or disposals are effective when the PP&E leaves the owner's custody. Proper documentation includes the physical quantity, location, and unit cost. The property records should be designed to assist making decisions related to procurement and use.

This is especially important as related to potential excess PP&E that may be available for reuse, transferred to another component, or disposed of. When disposed of through salvage or demolition, a copy of the original acquisition documentation and disposal documentation must be retained per the applicable NARA instructions.



Lesson Summary



- **Components of Real Property**
- **Capitalization Threshold**
- **Validating Reporting of Statements and Checklist Integrity**

Version 1.0

Preparation for a Real Property Audit

L1-36

In this lesson, we defined the components of real property such as land, buildings, capital leases, and land rights.

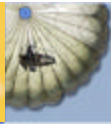
We discussed the DoD capitalization threshold for capital investments including the fact that the SFFAS allows the individual federal entities to set their own capitalization threshold based on mission, size, and other specific needs.

We described the DoDFMR specified capitalization threshold of \$100,000.

Next we illustrated the how the annual financial statements gain and maintain their integrity through checklists.

We also noted the importance of evidential matter, as present in the audit trail, to the proof of the Balance Sheet.

The following slides list references available for additional information.



References



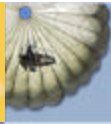
FAR: <http://www.arnet.gov/far/>

EO 13327:
http://www.archives.gov/federal_register/executive_orders/2004.html

DoDD 4165.6:
<http://west.dtic.mil/whs/directives/corres/dir1.html>

PAR: <http://www.dod.mil/comptroller/financialindex.html>

FAM: <http://www.gao.gov/special.pubs/gaopcie/>



References

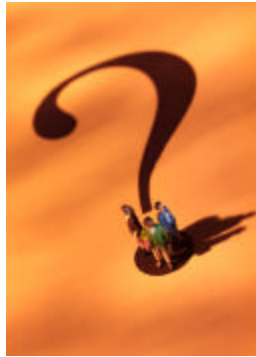
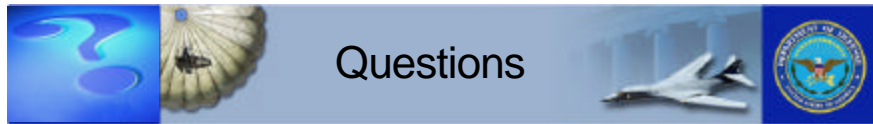


EC 405-1-02:

<http://www.hq.usace.army.mil/cere/ARs/EC%20405-1-02.doc>

DoDFMR: <http://www.dod.mil/comptroller/fmr/>

SFFAS: <http://www.fasab.gov/standards.html>



Do you have any questions on the material covered in this lesson?

This page intentionally left blank.

Review 1. Real Property Requirements and Financial Statements Practice Exercise

Directions This is an open-book practice exercise to assess your knowledge of Lesson 1, Defining Real Property Components, with emphasis on real property identification and the impact on footnotes and financial statements.

There are six questions below in the form of multiple choice, fill in the blank, and matching. Write in or circle the answers to the questions. The supplemental documents contained in Figures R1-1 through R1-6 of the back of this exercise are for your response to Question 6.

Time Allocation The time allocated to this practice exercise is 15 minutes: 10 minutes for the exercise and 5 minutes for the review and discussion.

Number	Question
1	The financial statement classifications of Real Property are _____, _____, and _____. Of these, only _____ is shown on the Balance Sheet.
2	Contractors in possession of DoD real property must inventory it _____. a. with a 100% physical inventory at least every five years b. in accordance with contract/FAR requirements c. according to internal company policies d. by September 30 of each fiscal year
3	Identify the incorrect statement about real property. a. Usually, real property is recognized by the DoD Component acquiring it. b. If Military Component A is occupying a facility on Military Component B's installation, Component A should record and depreciate the facility. c. All medical PP&E Real Property equipment and facilities are reported on the annual general fund financial statements of the Military Department that owns the installation where the medical facility resides. d. Maintenance and repair costs are not capitalized improvements.

[illegible]

Department of Defense		
Agency Wide		
CONSOLIDATED BALANCE SHEET		
As of September 30, 2004 and 2003		
(\$ in Millions)		
	2004 Consolidated	2003 Consolidated Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 287,685.5	\$ 251,544.1
Non-Entity Seized Iraqi Cash	113.4	278.1
Non-Entity-Other	1,800.0	239.8
Investments (Note 4)	231,069.7	205,376.0
Accounts Receivable (Note 5)	1,118.3	1,066.6
Other Assets (Note 6)	1,011.9	105.0
Total Intragovernmental Assets	\$ 522,798.8	\$ 458,609.6
Cash and Other Monetary Assets (Note 7)	\$ 2,178.1	\$ 1,534.9
Accounts Receivable (Note 5)	7,427.8	7,299.9
Loans Receivable (Note 8)	70.7	64.0
Inventory and Related Property (Note 9)	213,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
Investments (Note 4)	406.5	217.8
Other Assets (Note 6)	21,486.3	21,729.6
TOTAL ASSETS	\$ 1,208,486.2	\$ 1,141,309.3
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,888.4	\$ 101.4
Debt (Note 13)	591.8	698.2
Environmental Liabilities (Note 14)	0.0	0.0
Other Liabilities (Note 15 & Note 16)	10,726.9	9,739.1
Total Intragovernmental Liabilities	\$ 13,207.1	\$ 10,538.7
Accounts Payable (Note 12)	\$ 28,309.0	\$ 27,863.8
Military Retirement Benefits and Other Employment-Related	1,569,704.7	1,429,565.5
Actuarial Liabilities (Note 17)		
Environmental Liabilities (Note 14)	64,367.2	61,490.6
Loan Guarantee Liability (Note 8)	34.4	25.9
Other Liabilities (Note 15 and Note 16)	34,491.2	30,154.0
Debt Held by Public	0.0	0.0
TOTAL LIABILITIES	\$ 1,710,113.6	\$ 1,559,638.5
NET POSITION		
Unexpended Appropriations (Note 18)	\$ 243,813.9	\$ 218,869.5
Cumulative Results of Operations	(745,441.3)	(637,198.7)
TOTAL NET POSITION	\$ (501,627.4)	\$ (418,329.2)
TOTAL LIABILITIES AND NET POSITION	\$ 1,208,486.2	\$ 1,141,309.3
DoD Performance and Accountability Report	115	Part 3: Financial Information

Figure R1-1, Consolidated Balance Sheet

Note 10. General PP&E, Net

As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	\$ (91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term 2-5 Or	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease ¹	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9

¹ See Note 15 on Capital Lease Liability for additional information

Legend for Valuation Methods

S/L = Straight Line N/A = Not Applicable

Fluctuations

General Property, Plant and Equipment (PP&E) decreased \$5.4 billion (1 percent). The significant changes are summarized below:

Buildings, Structures and Facilities decreased 8.4 billion (11 percent). The majority of this decrease was the result of an error in Navy General Fund data captured for FY 2003 accumulated depreciation. This error was corrected in FY 2004.

Leasehold Improvements reflected a net decrease of \$53.4 million (56 percent). The decrease is primarily attributable to the DFAS Working Capital Fund's one-time reclassification of \$48.3 million from Buildings, Structures and Facilities to Leasehold Improvements in FY 2003.

Figure R1-2, Note 10 to the Consolidated Balance Sheet, Page 1

In FY 2004, the Department elected to display Military Equipment and General Equipment on separate lines for reporting purposes. The breakdown of the FY 2003 balance is a net book value of \$13 billion for General Equipment and \$325.1 billion for Military Equipment, therefore the true increase in General Equipment is \$3 billion. This increase is the result of the procurement of new equipment and better recognition of existing equipment.

Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in millions)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	\$ 574.6	\$ 574.6
B. Equipment	11.3	2.6
C. Accumulated Amortization	(379.2)	(343.6)
D. Total Capital Leases	<u>\$ 206.7</u>	<u>\$ 233.6</u>

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

Fluctuations

Assets Under Capital Lease decreased \$26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

Figure R1-3, *Note 10 to the Consolidated Balance Sheet, Page 2*

DoD Financial Management Regulation**Volume 4, Chapter 6****★ August 2000**060206. Depreciation.

A. General. DoD General PP&E assets are those assets that have an acquisition or recorded cost that equals or exceeds the DoD capitalization threshold and have a useful life of two or more years--often called "capital assets" or "fixed assets." DoD General PP&E includes all capital assets that are not ND PP&E, Heritage Assets or Stewardship Land. DoD General PP&E shall be capitalized and, with the exception of land and land rights of unlimited duration, shall be depreciated. Land rights that are for a specified period of time shall be amortized (depreciated) over that time period. Such capitalized amounts, as well as associated amounts of accumulated depreciation and depreciation expense, shall be reflected in DoD financial statements.

B. Method of Depreciation. Department of Defense policy permits the use only of the straight-line method of depreciation.

C. Recorded Cost. The recorded cost is the acquisition cost of an asset plus any ancillary costs required to bring the asset into an operating condition. Examples of costs required to bring an asset into an operating condition include freight fees, handling and storage costs, installation costs, and set-up costs. See paragraph 060202.B of this Chapter for a more comprehensive list of these ancillary costs.

D. Salvage Value. The salvage value, also known as the residual or scrap value, is the amount that would be expected to be obtained from selling the asset at the end of its useful life, but only when such proceeds (from recycle, resale, salvage, etc.) are permitted to be retained and used by the DoD Component. Typically, personal property (e.g., vehicles, ADP and equipment) will not have a salvage value. If the asset is to be traded in on a new asset, the salvage value is the expected trade-in value. For purposes of computing depreciation, real property assets (e.g., buildings, facilities and structures) do not have salvage values.

E. Depreciable Basis. The depreciable basis of a General PP&E asset is the recorded cost reduced by the asset's salvage value, if such salvage value exceeds 10 percent of the asset's cost. If the salvage value is 10 percent or less of the asset's cost, the salvage value is not considered material for purposes of calculating depreciation, and therefore, should not be considered when determining the depreciable basis. (In other words, if the salvage value is less than or equal to 10 percent of the asset's cost, the depreciable basis should be the same as the recorded cost.) Land is not subject to depreciation. Land rights that are for a specified period of time shall be amortized over the specified time period. When land and a building are purchased together, the depreciable basis for the building is the total purchase cost less the actual cost, or estimated value, of the land.

F. Useful Life. For purposes of computing depreciation on DoD General PP&E assets, specific recovery periods are prescribed. Table 6-7 reflects the recovery periods to be used for DoD General PP&E.

Figure R1-4, *DoDFMR, Paragraph 060206 (A through F)*

DoD Financial Management Regulation**Volume 4, Chapter 6****★ August 2000**

G. Commencement of Depreciation. The event that triggers the calculation of depreciation is the date of receipt shown on the asset receiving document or the date installed and ready for use (regardless of whether it is actually used). In the case of constructed PP&E, the costs of constructing the PP&E shall be recorded as construction-in-progress until it is available for use, at which time the balance (total construction costs) shall be transferred to General PP&E. In the case of constructed real property, depreciation shall commence when the building is available for use, regardless of whether the building is fully occupied. The actual commencement of depreciation shall be based on either of the following methods:

1. Month Available for Service Method. Under the Month Available for Service Method, the month the asset was available for use, regardless of whether it was actually used, is the month used to commence the calculation of depreciation expense for the first year.

2. Mid-Year Convention Method. Under the Mid-Year Convention Method, six months of depreciation is computed and expensed in the first and last year of an asset's useful life, regardless of the actual month the asset was placed in, or removed from, service.

H. Excess of Useful Life. If an asset remains in use longer than its estimated useful life, it shall be retained in the property accountability or management system, as well as the accounting records, and reflect both its recorded cost and accumulated depreciation until disposition of the asset.

I. Calculation of Depreciation. Depreciation expenses shall be calculated and accumulated using the straight-line method based on the recorded cost less salvage value, and divided equally among accounting periods during the asset's useful life based on recovery periods in Table 6-7 of this Chapter. Salvage value will be used in the calculation only if it exceeds 10 percent of the cost of the asset.

J. Recovery Periods. Table 6-7 prescribes the recovery periods (useful lives) that shall be used for depreciable General PP&E assets.

Figure R1-5, *DoDFMR, Paragraph 060206 (G through J)*

DoD Financial Management Regulation**Volume 4, Chapter 6****★ August 2000**

DoD RECOVERY PERIODS FOR DEPRECIABLE
GENERAL PP&E ASSETS
(Excludes National Defense PP&E and Heritage Assets)

Description of General PP&E Assets	Recovery Period
General Purpose Vehicles (Includes Heavy Duty Trucks and Buses); ADP Systems and Hardware (Computers and Peripherals); High Tech Medical Equipment; Equipment used in Research, Development, Test and Evaluation (RDT&E); Radio and Television Broadcasting Equipment; and Software	5 Years*
Improvements to 5-Year Recovery Period Property (Personal Property)	
All Other Equipment, Machinery and Software**	10 Years
Improvements to 20-Year Recovery Period Property	
Vessels, Tugs, Barges and Similar Water Transportation Equipment (Non-National Defense PP&E vessels/ships) Steam (12.5K pounds per hour or more) and Electric Generation Equipment (500 Kilowatt or more), Sewers and Other Utilities (including such things as fiber optic cable)	20 Years
Fences, Roads, Bridges, Towers, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities and Other Real Property Structures.	
Improvements to 40-Year Recovery Period Property	
Buildings, Hangers, Warehouses, Fuel Storage Buildings, Air Traffic Control Towers, and Other Real Property Buildings	40 Years
Improvements to Leased Buildings and Other Real Property (Leasehold Improvements)	Remainder of Lease Period or 20 Years Whichever Is Less
Land Rights of Limited Duration	Over the Specified Duration
TABLE 6-7	

* A recovery period of less than 5 years is permitted when the acquiring DoD Component is certain that the useful life of an asset is at least 2 years but less than 5 years. In such circumstances, the recovery period shall be the known useful life (2-4 years, as appropriate).

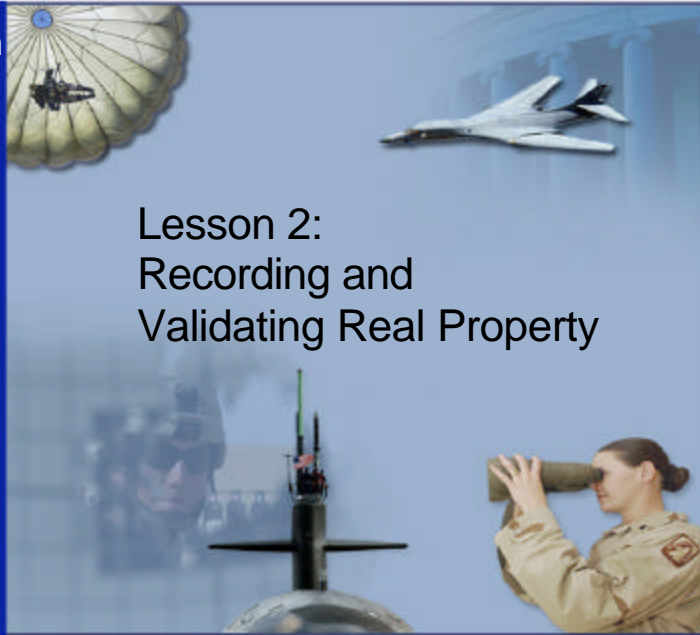
** Depending on the nature of the software, it may be depreciated over a period of less than 5 years, 5 years or 10 years. The determining factor should be the actual estimated useful life of the software consistent with that used for planning the software's acquisition.

Figure R1-6, *DoDFMR, Table 6-7*

Preparation for a Real Property Audit



Lesson 2: Recording and Validating Real Property



In Lesson 2, you will learn how to record and validate real property as the construction agent sees it and as a customer or user sees it.

Let's discuss the lesson objectives.



Lesson Objectives



Upon successful completion of this lesson, you will be able to:

- **Explain how to record real property**
- **Explain how to determine preponderant use of real property**
- **Recognize construction-in-progress**
- **Discuss real property recording implications**
- **Explain how to account for real property exceptions**
- **Identify supporting documentation**

Version 1.0

Preparation for a Real Property Audit

L2-2

Lesson 2 focuses on how to value real property, particularly as it relates to the financial statements. This is primarily accomplished by an examination of Construction In Progress (CIP) and related financial statements.

We also discuss how to account for some exceptions within Working Capital Funds (WCFs).

Finally, we will examine the required supporting documentation.



Lesson Topics



This lesson contains the following topics:

- **Recording Real Property Inventory**
- **Preponderant Use**
- **Construction-in-Progress (CIP)**

In this lesson, we discuss real property to ensure it is properly recorded.

How to determine preponderant use is examined and then we look at recording of construction-in-progress (CIP) from the builder's point of view, as well as the customers.



Lesson Topics (cont.)



This lesson contains the following topics (cont.):

- **Financial Statement Implications for Construction Agents**
- **Financial Statement Implications for Users**
- **Business Rules**
- **Using the Checklist to Identify Supporting Documentation**
- **Review Exercise**

Version 1.0

Preparation for a Real Property Audit

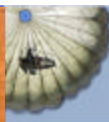
L2-4

In this lesson, we discuss real property recording implications for the financial statements of both the construction agents and their customers.

WCFs are explained including how to account for various real property business rules.

We will identify supporting documentation using checklists.

Finally, we will perform a review exercise to help you retain the concepts covered in this lesson.



Recording Real Property Inventory



Recording Real Property Costs

- **Historical acquisition cost, plus other costs to get it ready for use, less any depreciation**
- **Fair market value can be used to record an asset**
- **An audit objective to determine if the financial statement balances are properly stated**

Version 1.0

Preparation for a Real Property Audit

L2-5

In general, the basis for recording real property provides that it is entered in the accounting records and presented in the financial statements at historical cost less any related depreciation or amortization. Applicable costs also include those necessary to bring the real property to the condition and location necessary for its intended use.

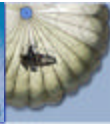
The historical acquisition cost of purchased or constructed real property includes payments for the contracted price plus freight; materials, supplies, labor, and services used in construction or installation; and any title examination and recording fees.

When cost is not available, you can use an alternative method for recording cost as outlined in the DoDFMR, Volume 4, Chapter 6.

The fair market value can be used to record an asset. The fair market value is an unbiased, equitable or just value based on the cost of a similar asset or the price that an impartial buyer would be willing to pay for the asset or a similar asset.

An objective of auditors is to determine how an asset was recorded. In this reference, recording relates to whether the financial statement balances are properly stated. In this part of the lesson, you will learn how to record the real property amount that is reflected in the General PP&E line on the Balance Sheet.


Let's get started with a discussion of the DoD Directive 4165.6.



Recording Real Property Inventory (cont.)



DoD Directive 4165.6, Real Property, October 13, 2004

	Department of Defense DIRECTIVE
	NUMBER 4165.6 October 13, 2004
<hr/>	
USDA(1&L)	
SUBJECT: Real Property	
References: (a) DoD Directive 4165.6, "Real Property Acquisition, Management, and Disposal," September 1, 1987 (hereby canceled)	
(b) Executive Order 13327, "Federal Real Property Asset Management," February 9, 2004	
(c) DoD Directive 4700.3, "Mineral Exploration and Extraction on DoD Lands," September 28, 1983 (hereby canceled)	
(d) DoD Directive 5160.63, "Delegation of Authority Vested in the Secretary of Defense to Take Certain Real Property Actions," June 3, 1986 (hereby canceled)	
(e) through (g), see enclosure 1	
1. REISSUANCE AND PURPOSE	
This Directive:	
1.1. Renames and revises reference (a) to provide DoD policy on the acquisition, management, and disposal of real property consistent with reference (b).	
1.2. Cancels references (c) and (d).	
1.3. Delegates or redelegates statutory and regulatory authorities and responsibilities relating to the acquisition, management, and disposal of real property consistent with reference (b).	
2. APPLICABILITY	
This Directive applies to:	
2.1. The Office of the Secretary of Defense, the Military Departments (including their Reserve components), the Chairman of the Joint Chiefs of Staff, the Combined Commands, the Office of the Inspector General of the Department of Defense, the Defense Agencies, the DoD Field Activities, and all other organizational entities in the Department of Defense (hereafter referred to collectively as the "DoD Component").	
1	

Version 1.0

Preparation for a Real Property Audit

L2-6

Where do you begin? The answer depends on where you work. According to DoD Directive 4165.6, the acquisition, management, and disposal of real property is a function of the Military Departments acting on behalf of the DoD. Components must meet the Department's requirements by using their own policies as well as those of the DoD. This means that each Component may have unique processes, systems, and forms that meet the overall objectives of the Department. This can make generalizations difficult, so let's look at an example.

If you worked in the Air Force's Working Capital Fund, you would need to know the composition of the real property lines in Note 10 as shown in this next slide.



Recording Real Property Inventory (cont.)



Air Force Working Capital Fund

Note 10. General Property, Plant, and Equipment (PP&E), Net

As of September 30	2004				2003	
	Depreciation/Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 0	N/A \$ 0	\$ 0	\$ 0
B. Buildings, Structures, and Facilities	S/L	20 or 40	809,105	-559,957	249,229	235,804
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	3-5 or 10	978,030	-608,565	369,465	804,652
E. General Equipment	S/L	5 or 10	2,044,659	-1,493,532	551,428	227,947
F. Military Equipment	S/L	various	0	0	0	0
G. Assets Under Capital Lease (1)	S/L	lease term	0	0	0	0
H. Construction-in-Progress	N/A	N/A	27,563	N/A	27,563	27,894
I. Other			0	0	0	28,772
J. Total General PP&E			\$ 3,839,747	\$ -2,052,064	\$ 1,787,683	\$ 1,329,029

1) Note 15.0 for additional information on Capital Leases

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

Version 1.0

Preparation for a Real Property Audit

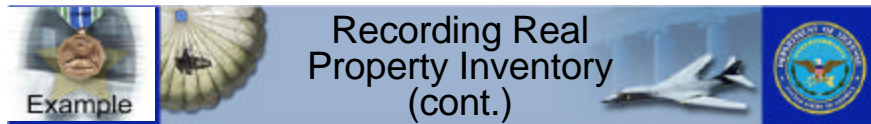
L2-7

Here we have the Air Force Working Capital Fund's Note 10 to the applicable Balance Sheet. Examine Lines 1.A, 1.B, 1.C, and 1.H to find the reported real property. In FY 2004, they report no land or lease improvements, about \$27.6 million dollars in CIP, and a considerable \$249.2 million as the Net Book Value of 1.B, Buildings, Structures, and Facilities. The Net Book Value is the acquisition value less any accumulated depreciation/amortization. The explanation accompanying this note is an example of what we are discussing.

The explanation included with the note says that real property reported by the Automated Civil Engineer System (ACES) has not been validated and reconciled to reported figures received by Defense Finance and Accounting Service (DFAS) from the field activities.

This means the reconciliation of the accounting statements had not occurred as of the date of this statement. The note explains that the Depot Maintenance Air Logistics Centers and Aerospace Maintenance and Regeneration Center use the ACES to capture the costs of real property based on preponderance of use for each building. They use the straight-line method for recording depreciation. The accounting entries are recorded directly into the field-level trial balances.

While this process may be necessary due to current system inability to capture and report information, it brings home the importance of ensuring that current records are being reconciled and reported correctly. The method that the Air Force chose to remedy the problem is shown on the next slide.



Air Force Civil Engineering Support Agency (AFCESA) Contract Number GS-10F-0198J, BPA Number GS04T03BFA0024

On September 30, 2003, Intergraph Corporation was awarded the Air Force Civil Engineering Support Agency (AFCESA) contract, Contract Number GS-10F-0198J, BPA Number GS04T03BFA0024. Under this contract, Intergraph will conduct comprehensive real property inventories, reconcile facilities against existing documentation and drawings, update or recreate floor plans, validate findings and update the Automated Civil Engineering System (ACES) records. Installations will use the information to improve installation management and document real property uses and values.

Intergraph will support the Headquarters, U.S. Air Force Civil Engineering Support Agency (AFCESA) in updating real property records for all Air Force bases worldwide. Valued at \$10 million, the five-year General Services Administration (GSA) blanket purchase agreement (BPA) enables Air Force installations to acquire information technology and knowledge management services needed to improve property management. Intergraph will provide consulting, installation management, database and computer-aided drafting (CAD) expertise.

Version 1.0

Preparation for a Real Property Audit

L2-8

In this example, the property accountability records maintained in ACES require validation. Whether you choose to contract out or perform the functions in-house, this slide shows the steps required to correctly report the Balance Sheet numbers in the first paragraph.

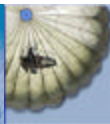
It begins with a comprehensive inventory to determine what really does exist. This is then reconciled to existing documentation to determine that all the inventory items are supported by appropriate evidential matter.

Next, the automated accountability records (here that's ACES) are updated and reconciled to the accounting records. You should then document real property uses and values to ensure that appropriate amounts are recognized, meaning at cost less depreciation.

It's also important to ensure that maintenance and repair expenses aren't capitalized – further distorting the Balance Sheet valuation.

The bottom line is to ensure that your real property is appropriately described and classified in Note 10 to the Balance Sheet and that you can trace the notes to source documentation.

Let's see how real property is reported upward and ultimately shown in the Department's Consolidated Balance Sheet.



Recording Real Property Inventory (cont.)



Asset Section of U.S. Air Force Balance Sheets

Consolidated Balance Sheet—Working Capital Fund		
As of September 30, 2004 and 2003 (\$ in Thousands)		
	2004 Consolidated	2003 Consolidated
1. ASSETS (Note 2)		
A. Intra-governmental:		
1. Fund Balance with Treasury (Note 3)		
a. EFM	\$ 1,851,190	\$ 752,842
b. Non-Gratuity Special Ineq Cash	0	0
c. Non-Gratuity Other	0	0
2. Investments (Note 4)	0	0
3. Accounts Receivable (Note 5)	\$70,380	\$05,877
4. Other Assets (Note 6)	0	0
5. Total Intra-governmental Assets	\$ 1,821,570	\$ 752,842
B. Cash and Other Monetary Assets (Note 7)	\$ 0	\$ 0
C. Accounts Receivable (Note 8)	103,711	107,704
D. Loans Receivable (Note 9)	0	0
E. Investments and Related Property (Note 10)	\$1,851,190	\$05,842
F. General Property, Plant and Equipment (Note 11)	1,197,683	1,325,420
G. Intangible Assets (Note 12)	0	0
H. Other Assets (Note 13)	750,000	350,000
2. TOTAL ASSETS	\$ 2,474,284	\$ 2,235,966

Consolidated Balance Sheet—General Fund		
As of September 30, 2004 and 2003 (\$ in Thousands)		
	2004 Consolidated	2003 Consolidated
1. ASSETS (Note 2)		
A. Intra-governmental:		
1. Fund Balance with Treasury (Note 3)		
a. EFM	\$ 48,542,708	\$ 48,714,188
b. Non-Gratuity Special Ineq Cash	0	0
c. Non-Gratuity Other	0	0
2. Investments (Note 4)	711	712
3. Accounts Receivable (Note 5)	688,871	581,429
4. Other Assets (Note 6)	688,871	581,429
5. Total Intra-governmental Assets	\$ 49,232,360	\$ 49,897,339
B. Cash and Other Monetary Assets (Note 7)	\$ 311,323	\$ 147,404
C. Accounts Receivable (Note 8)	876,885	772,588
D. Loans Receivable (Note 9)	0	772,588
E. Investments and Related Property (Note 10)	\$2,348,148	\$2,415,348
F. General Property, Plant and Equipment (Note 11)	117,354,430	112,798,110
G. Intangible Assets (Note 12)	0	0
H. Other Assets (Note 13)	13,888,584	9,647,150
2. TOTAL ASSETS	\$ 183,730,321	\$ 173,078,939

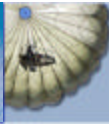
Version 1.0

Preparation for a Real Property Audit

L2-9

A moment ago, we saw that Note 10 to the WCF Balance Sheet contained real property for FY 2004 of just under a quarter of a billion dollars. It also showed the total General PP&E for FY 2004 to be \$1,197,683 (in thousands). This same amount is shown on line “F” of the Balance Sheet here on the left side of the slide.

Several Components have two Balance Sheets, one for the General Fund and one for the WCF. These represent the consolidated position, for each fund, for this Component, at this point in time. The asset section of the Air Force General Fund is presented here on the right of the slide to show the compilation process that takes place. These amounts are rolled together with other Components and displayed on the Department's Consolidated Balance Sheet shown on the next slide.



Recording Real Property Inventory (cont.)



Department of Defense Agency Wide CONSOLIDATED BALANCE SHEET As of September 30, 2004 and 2003 (\$ in Millions)		
	2004 Consolidated	2003 Consolidated Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 287,685.5	\$ 251,544.1
Non-Entity Seized Iraqi Cash	113.4	278.1
Non-Entity-Other	1,800.0	239.8
Investments (Note 4)	231,069.7	205,376.0
Accounts Receivable (Note 5)	1,118.3	1,066.6
Other Assets (Note 6)	1,011.9	105.0
Total Intragovernmental Assets	\$ 522,798.8	\$ 458,609.6
Cash and Other Monetary Assets (Note 7)	\$ 2,178.1	\$ 1,534.9
Accounts Receivable (Note 5)	7,427.8	7,299.9
Loans Receivable (Note 8)	70.7	64.0
Inventory and Related Property (Note 9)	213,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
Investments (Note 4)	406.5	217.8
Other Assets (Note 6)	21,486.3	21,729.6
TOTAL ASSETS	\$ 1,208,486.2	\$ 1,141,309.3

Version 1.0

Preparation for a Real Property Audit

L2-10

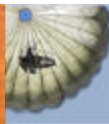
Let's look at the General Property, Plant, and Equipment Line and the reported amount for FY 2004 of \$440,898 (in millions).

This includes the Air Force dollars plus the other services.

This line of the Department's financial statements has contributed to DoD's inability to obtain an unqualified audit opinion.

Your best effort to record the PP&E line on the Balance Sheet is necessary to accomplish the Department's goal of an unqualified audit opinion.

Let's discuss what is preponderant use.



Preponderant Use



What happens when the preponderant user of the real property is:

- **Not the owner**
- **Not the DoD Component that financed it**

The real issue is, “How do you determine preponderant use of real property for accounting and reporting purposes?”

Actually, there are four criteria that must be met for you to recognize real property.

Let’s look at the four criteria.



Preponderant Use (cont.)



First, the asset must embody a probable future benefit that will contribute to the Component's operations.

Example:

- **Building on a Military installation used by a Defense agency**
- **The agency pays for utilities and maintenance**
- **The building is of future benefit to the agency allowing it to continue its operations**

Version 1.0

Preparation for a Real Property Audit

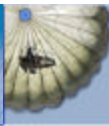
L2-12

For example, a building on a Military installation used by a Defense agency provides space for its operations, allowing it to achieve its mission. This agency also pays for the utilities, maintenance, and upkeep of the building.

This has traditionally been known as a service capacity or the ability of the real property to directly influence the success of the Component's mission.

This has value because it's consumable or exchangeable for other benefits. This is true for real property in the federal government even though the exchangeability part of the benefit or the ability to sell, trade, or donate the property may not be present.

Just because a Component can't exchange the benefit for other benefits does not preclude the asset from meeting this first criterion shown on the slide.



Preponderant Use (cont.)



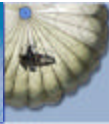
Second, the Component that reports the asset must be able to obtain the benefit and control access to the benefit inherent to the real property.

Example:

- **The Defense agency in the previous example derives the benefit of the building**
- **The agency controls access in that they are the occupant and no one else is reporting the asset on their financial statement. This may be based on a memorandum of understanding**

The second criterion refers to the Component's ability to direct who derives the benefit, the timing of when the benefit is derived, and under what conditions it is derived. Traditionally, this has meant possession or the ability to exert significant influence over the benefits like that achieved in a Memorandum Of Understanding (MOU).

Generally, when a Component maintains possession of property through agreements that provide for possession for as long as needed without a termination date, and without reimbursement, these arrangements are generally considered as providing sufficient influence over the use of the property to satisfy this criterion.



Preponderant Use (cont.)

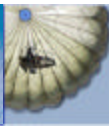


Third, the transaction or event giving a Component the right to and control over the benefit of the real property must have already occurred.

Example:

- **The memorandum mentioned in the previous example must be in place allowing the agency rights to the building**
- **The agreement may be express or implied meaning even if it doesn't specifically say you have rights and control over the building, you do**

The third criterion is pretty straightforward. The transaction or event giving a Component the right to and control over the benefit of the real property must have already occurred. Basically, this is an agreement (express or implied) that allows a Component to occupy and use the asset without reimbursement for as long as needed.



Preponderant Use (cont.)



Fourth, the Component only reports predominately used real property owned by other Components when their costs, taken as a whole, are material to the predominate user's financial statements.

All facilities used by a Defense agency are considered material and therefore reported and depreciated by that agency.

Version 1.0

Preparation for a Real Property Audit

L2-15

The fourth criterion that must be met says that each Component's costs should also include the full cost of goods and services that it receives from other Components. However, this is limited to material items or amounts that are significant to the receiving Component and form an integral part of the receiving Component's output. Two general rules to follow state that one service branch doesn't recognize or report facilities occupied on another's installation; and the Defense agencies that are included in the Department's Consolidated Financial Statements will recognize and report the facilities used in their operations.

Here are a couple of scenarios to show how to implement the Department's preponderant use policy.

The first one is an Air Force tenant on an Army installation where the Air Force is the predominant user of a certain building. The Army should report the building on its financial statements, not the Air Force. The cross-use of real property among Military Departments is recognized as routine practice and has an immaterial net effect on each service's financial statements.

Next, let's look at an example of capital improvement.



Preponderant Use (cont.)



Capital Improvement Example

Original Asset	
Original Facility Acquisition Cost	\$200,000.00
<i>Financial Reporting Entity for Acquisition Cost</i>	<i>Air Force</i>
Capital Improvement	
Capital Improvement Cost	\$100,000.00
Capital Improvement Organization	Army
<i>Financial Reporting Entity for Capital Improvement</i>	<i>Air Force</i>

**The Army is a tenant on an Air Force installation,
the Air Force is the preponderant user of the facility.**

Version 1.0

Preparation for a Real Property Audit

L2-16

In the example above, the Army occupies a facility on the Air Force installation. Because it is not the preponderant user of the space, the Air Force performs the financial reporting for the acquisition cost and any capital improvements. The cost of a capital improvement that is exclusively funded by one organization shall be recognized and reported on the funding organization's financial statements.

However, if the cost of a capital improvement is funded by multiple organizations and embodies future benefits that contribute to the operations of those organizations shall be allocated on a prorated basis to the funding organizations and reported on their financial statements.

Next, let's look at how to report real property that is not in the United States.



Preponderant Use (cont.)



Facilities Outside the Continental United States (OCONUS)

Four criteria for recognizing OCONUS real property:

- Occupied without reimbursement
- Component controls access
- Length of use is unspecified
- Component maintains and repairs the facility



The fact that the real property may be returned to the provider is irrelevant.

Version 1.0

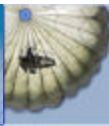
Preparation for a Real Property Audit

L2-17

When all of the following criteria are met, Department facilities located OCONUS are recognized and reported as the real property of the using Component.

First, the facilities must be occupied without reimbursement to the host nation. Second, the Component has to control access to or use of the facility. Third, use of the facility is for an unspecified length of time. And finally, the Component must maintain and repair the facility.

This includes facilities that were confiscated during military operations, those built with international funds – like the North Atlantic Treaty Organization (NATO) – and those built with the host nation's funds. The fact that these facilities may be returned to the provider when the Component permanently leaves is not relevant for purposes of accounting and financial statement reporting. Due to its unique nature and the fact that it will eventually be returned, reporting Components have some latitude. Specifically, if the property is recorded without a historical acquisition cost or estimate and the property would be substantially or fully depreciated, no effort will be made to determine an estimated acquisition cost. However, Components will comply with all property accountability policies and requirements, as well as the appropriate accounting and reporting requirements, when capital improvements are made. These facilities are not treated as capital leases unless there is a specific agreement with the host nation equivalent to an installment purchase. The quantity and/or value of the OCONUS facilities and the unique convertible nature of them will be disclosed in Note 10 to the Balance Sheet of the Component's annual financial statements.



Preponderant Use (cont.)



MOU/Agreement:

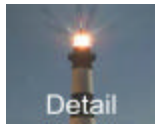
- **Clarifies accounting and reporting responsibilities**
- **Clarifies accountability reporting responsibilities**

When a resolution cannot be reached, it is referred to the OUSD(C). Provide sufficient supporting documentation to assist in resolving the matter and submit through your applicable financial management authorities and comptroller.

How do you handle situations where doubt exists as to who should recognize an asset?

You develop an MOU or Agreement. An important aspect to ensure is that the overall accounting records of the Department and the federal government are not duplicated and that the responsible party maintains accountability for the asset.

In the rare situation that an agreement can't be reached, it is referred to the OUSD(C) for resolution. Requests have to contain enough supporting documentation to assist in resolution of the matter and be submitted through the Financial Management and Comptroller of the submitting Military Department or Defense agency.



Preponderant Use (cont.)



Business rules for medical facilities:

- Funding is centralized
- Command and control is de-centralized
- Military installation is preponderant user
- Reported on the statements of the Military Department that owns the installation

Business rules for fuel facilities:

- Funding is centralized by the DLA
- Command and control is de-centralized
- DLA is preponderant user
- Reported on the DLA's financial statements

Version 1.0

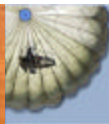
Preparation for a Real Property Audit

L2-19

Where the Department's medical activities are concerned, there are business rules that apply. This is because while most of the funding for medical activities is centralized through the Office of the Under Secretary of Defense (Health Affairs) (OUSD(HA)), the OUSD(HA) doesn't exercise command and control authority over them. Hospitals, clinics, and other medical facilities are usually located on military installations where their mission is to serve the personnel and families in the local area. Therefore, the military installation is the preponderant user of the medical facility and all medical real property is reported on the annual general fund financial statements of the Military Department that owns the installation. This is applicable to real property purchased with General Funds regardless of Department Code – TI 17, 21, 57, or 97.

Another business rule is the fuel facilities funded by DLA. The Services operate them but the fuel facilities contain DLA-owned fuel exclusively. Thus they are "used" exclusively by DLA.

Next we examine recording of CIP.



Construction-in-Progress



What is construction-in-progress (CIP)?

CIP is a temporary classification of real property while it is being built, restored, or modernized. CIP can remain on the books for extended periods and includes structures and certain installed equipment.



Version 1.0

Preparation for a Real Property Audit

L2-20

Let's begin our discussion with an understanding of construction-in-progress. CIP is the accounting term that refers to the temporary classification of assets that are being built before being placed in service. You track these expenses in a special CIP general ledger account (1720) until they are completed. Depending on the size of each project, CIP can be accounted for on the books for several years. The Department may have numerous CIP projects with each project containing potentially hundreds of items being tracked, and each item may represent the sum of numerous expenses. The sum of the individual expenses for an item in a project will determine the value of the fixed asset when placed into service. Total spending for each item and the overall project is budgeted at the beginning of a project and tracked closely. Accounting for CIP can apply to everything from building barracks, bridges, office buildings, or anything the Department needs in the way of real property.

In addition to the facility being built, the cost of equipment installed as an integral part of it or that normally could not be removed without dismantling the property is included in the CIP account. Examples of such equipment include heating and air conditioning systems and elevators. Costs included in the CIP account are accumulated regardless of the source of funding and include direct labor, direct material, and overhead. Generally, the cost of demolition of a building is expensed; however, if an existing building is razed as part of site preparation for a new building, the cost of the demolition is included in the cost of the new building. Cost of upfront Engineering and Design will be included in the CIP. If the project gets cancelled, the amount accumulated in CIP will be expensed.

Let's look at additional details about the recognition of CIP.



Construction-in-Progress (cont.)



CIP is reported on the financial statements of the eventual beneficiary. For the builder, CIP includes:

- **Overhead (costs of construction that benefit more than a single construction project)**
- **Costs for general engineering studies and surveys**

Expense costs are those:

- **That are not reasonably going to be pursued**
- **That occur prior to construction authorization**

Version 1.0

Preparation for a Real Property Audit

L2-21

CIP is normally maintained on the books of the eventual beneficiary. However, since construction is performed by various entities within the federal government and by various Components within the DoD, the specific handling may vary. In the typical situation where the U.S. Army Corps of Engineers (USACE) or Naval Facilities Engineering Command (NAVFAC) constructs real property for another Component within the Department, it is clearly CIP of the Department and should be recognized as such on the Component's financial statements. However, in the case of assets built for Federal agencies outside the Department, the terms of the agreement must be reviewed and the exact nature of the accounting treatment will depend on the details of the transaction.

The builder will closely monitor construction overhead costs as they include any cost of construction that benefits more than a single construction project. Overhead may include costs for supervision and other indirect labor, supplies and materials, transportation, and depreciation. The overhead may be collected in cost pools and allocated to specific construction projects in proportion to the benefits received. The builder will also use the CIP account to capture costs incurred for general engineering studies and surveys that are expected to result in project construction. Management must review cost accumulations on a regular basis to ensure proper treatment. Costs related to projects not reasonably expected to be pursued must be written off. You should also expense any costs that occur prior to construction authorization. Recent indications from the DoD OIG show that although the CIP balance will be shown on the owner's books, the supporting documentation (e.g. progress payments, etc) will be obtained from the construction agent.

Next we see an example of coordination to ensure the proper collection and treatment of CIP.



Construction-in-Progress (cont.)

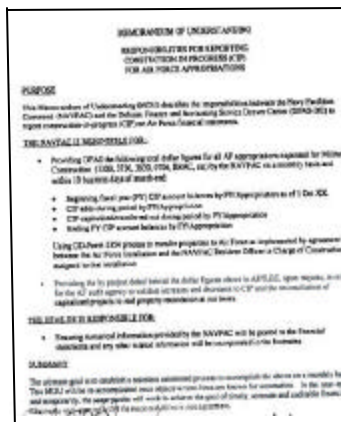


Example MOU

NAVFAC is providing USAF CIP information to DFAS with supporting documentation.

Capitalization threshold is \$100,000.

Capitalized real property is transferred from the CIP account to the real property account. If the threshold is not met, it is expensed. Sample documentation includes billings for materials, supplies and equipment; issues and transfers; receiving and shipping; invoices; payments; payrolls; DD Forms 1354; and reports of survey for losses.



Version 1.0

Preparation for a Real Property Audit

L2-22



In the memo on this slide, the NAVFAC has agreed to provide Air Force CIP information. Basically, it says that the CIP balances will be provided annually to DFAS along with supporting documentation in sufficient detail to reconcile the balances by project and funding source. In addition, NAVFAC will make any additional data available to DFAS upon request.

The next part of the process that you must pay close attention to is the capitalization threshold.



CIP costs are captured and accumulated by real property asset to help determine whether the capitalization threshold of \$100,000 has been met. Upon completion, if the accumulated costs meet the Department's capitalization threshold, the accumulated costs are transferred to the proper PP&E real property account. If the accumulated costs don't meet the threshold, the costs are expensed in the year management determines that the capitalization threshold was not or will not be met.


So what would you expect to use as sources of entries to the CIP account? They include things like billings under contracts for materials, supplies, and equipment; documented assignments of costs accumulated in cost pools; issue and transfer documents; receiving and shipping reports; invoices; payment vouchers; payroll records; reports of completed construction projects; construction acceptance documents; accounting records; reports of survey; and documented losses. Progress payments on contracts and other types of payments such as cost reimbursements also are included in the CIP account. So once the builder is finished, the property is transferred to the owner.

Let's take a look at those examples of information.

Construction-in-Progress (cont.)



ENGINEERING AND CONSTRUCTION BULLETIN


US Army Corps of Engineers


No. 2002-14 Issuing Office: CECW-ET / CEMP-MA Issued: 22 May 2002 Expires: 22 May 2004

Subject: MILCON Project Close-out, The RED ZONE Meeting

Applicability: Guidance

1. The U.S. Army Corps of Engineers is endorsing the Air Force's Air Combat Command (ACC) initiative called *The Red Zone Meeting* as an approach for timely completion and close-out for MILCON projects. The Red Zone meeting gets its name from the football term used to describe the team effort to move the ball the last 20 yards into the end zone. The close-out of a MILCON project sometimes can be equally as hard and most definitely requires the whole team's efforts.
2. The Red Zone meeting is held approximately 60 days before the anticipated Beneficial Occupancy Date (BOD). The whole Project Delivery Team (PDT) meets to discuss the close-out process, to build a schedule of events and assign responsibilities for actions necessary to produce a timely physical as well as fiscal close-out of the project. Enclosed is a copy of the ACC brochure describing their program.
3. The Corps of Engineers will apply the Red Zone meeting process to all MILCON projects. The Red Zone meeting should be included in every Project Management Plan (PMP). Ongoing projects with existing PMPs should incorporate Red Zone meetings if project BOD has not been reached. The Corps Project Manager will chair the meeting and ensure all the key players are in attendance. The enclosed sample checklist will help to ensure key milestones are discussed. The Word file for the sample checklist will be sent out with the distribution of this Engineering and Construction Bulletin. This file can be customized to include unique requirements for individual projects.
4. The Red Zone Video has been loaded on the Corps' FTP site at <http://ftp.hq.usace.army.mil/video>. The file name is *RedZonepresent.avi*. There are a few options to view the video: 1) You can double-click on the file name and the file will download and you can view through Windows Media Player. This download can take up to 5 minutes or so depending on your computer and Network traffic; 2) You can create a CD of the video by right clicking on the file at the ftp site. Choose "Save Target As" and a dialogue box will open up. Choose the directory where you want to save the file to and save the video file. Once the file is saved, then use your own CD creation software (like Adaptec) to create the CD. After you verify that the CD works, you can delete the file from your hard drive, and 3) Contact your local help desk and have the file copied to your local server and then you can view through the Media Player (as described above) but it will be faster than from the FTP site.


DWIGHT HERANEK, P.E.
Chief, Engineering and Construction Division
Directorate of Civil Works


JAMES TYLER, P.E.
Chief, Programs Management Division
Directorate of Military Programs

Version 1.0
Preparation for a Real Property Audit
L2-24

The final inspection described on this slide is a best practice that originated with the Air Force's Air Combat Command. It's an approach for timely completion and closeout of Military Construction (MILCON) projects. USACE has adopted this strategy for all of their MILCON projects.

At somewhere around 60 days prior to the anticipated Beneficial Occupancy Date (BOD) or placed in service date, the final inspection meeting is held:

- to discuss the close-out process
- to build a schedule and assign responsibilities.

The next slide shows common CIP recording concerns.



Construction-in-Progress (cont.)



Common CIP Recording Concerns

- **Ensure transfers occur quickly upon completion of the project**
- **Ensure proper recording to prevent negative CIP balances**
- **Ensure proper accounts are updated**

Version 1.0

Preparation for a Real Property Audit

L2-25

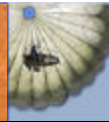
Audits have found transfers that didn't occur in a timely fashion upon project completion. One of the audit problems is an area we will discuss later, concerns CIP costs that couldn't be reconciled to evidential matter. They also found millions of dollars in negative CIP balances.

What might cause a negative balance in a CIP account?

Potential causes for a negative balance in the CIP account include transferring real property assets to the user at a greater value than was established in the CIP account; SGL errors in which account 1720 was credited when another account should have been credited.

It is important to validate the accounts being used, especially when manual input is required such as that used for journal voucher input.

The next slide shows a sample Red Zone checklist as we examine the valuation of CIPs received.



Construction-in-Progress (cont.)



SAMPLE
Red Zone Meeting Checklist
Date: _____

Contract No.	
Description / Location	
Contractor	
Contracting Officer	

Action	Completion Milestone	✓
Inspections		
Fire		
Safety		
Pre-final		
Mechanical Test & Balance		
Commissioning		
Landscaping Complete		
Beneficial Occupancy Date (BOD)		
Furniture Installation		
Comm installation		
As-Built Contract Drawings		
Provide all O&M manuals, tools, shop drawings, spare parts, etc. provided to customer		
Provide Warranty documents to Customer		
Contract completion		
Final Inspection		
User move-in		
DD Form 1354, Transfer of Real Property completed & signed		
Ribbon cutting		
DD Form 2626 - Construction Contractor Performance Evaluation		
DD Form 2631 - A-E Performance Rated after Construction		
Final Payment Completed		
Release of Claims		
Return of Unobligated Funds		
Move Project from CIP to General Ledger		
Financial completion		

When the building is available for use:

- The CIP balance is transferred to the real property account
- Depreciation begins

Version 1.0

Preparation for a Real Property Audit

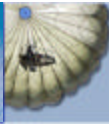
L2-26

The Red Zone Checklist shown here provides a methodical way to keep track of the events of the transfer of real property from the builder to the user. One item on the checklist, BOD, is the date the building is occupied. This date when the building is available for use is not dependent on whether the building has been officially transferred, or whether final payment has been made and the contract closed.

When the building is available for use, the balance in the CIP account is transferred to the appropriate real property account if accumulated costs equal or exceed the Department's capitalization threshold. If necessary, the balance transferred can be adjusted later, once the final payment has been made and the contract closeout process has been completed. However, as was previously mentioned, if the accumulated costs don't meet the threshold, they are expensed in the year management determines that the capitalization threshold was not met.

If the CIP is capitalized, you should start depreciation when the building is available for use, regardless of whether the building is fully occupied.

On the next slide, we examine depreciation in a little more detail.



Construction-in-Progress (cont.)



DoDFMR Volume 4, Chapter 6, Table 6-7

Straight-line Depreciation Method

If in use longer than its estimated useful life:

- Retain it on the accountability records
- Retain it on the accounting records
- Continue to report until final disposition

DoD Financial Management Regulation		Volume 4, Chapter 6 ★ August 2000
DoD RECOVERY PERIODS FOR DEPRECIABLE GENERAL PP&E ASSETS (Excludes National Defense PP&E and Heritage Assets)		
Description of General PP&E Assets	Recovery Period	
General Purpose Vehicles (Includes Heavy Duty Trucks and Buses); ADP Systems and Hardware (Computers and Peripherals); High Tech Medical Equipment; Equipment used in Research, Development, Test and Evaluation (RDT&E); Radio and Television Broadcasting Equipment; and Software	5 Years*	
Improvements to 5-Year Recovery Period Property (Personal Property)		
All Other Equipment, Machinery and Software**	10 Years	
Improvements to 20-Year Recovery Period Property		
Vessels, Tugs, Barges and Similar Water Transportation Equipment (Non-National Defense PP&E vessels/ships)		
Steam (12.5K pounds per hour or more) and Electric Generation Equipment (500 Kilowatt or more); Sewers and Other Utilities (including such things as fiber optic cable)	20 Years	
Fences, Roads, Bridges, Towers, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities and Other Real Property Structures.		
Improvements to 40-Year Recovery Period Property		
Buildings, Hangars, Warehouses, Fuel Storage Buildings, Air Traffic Control Towers, and Other Real Property Buildings	40 Years	
Improvements to Leased Buildings and Other Real Property (Leasehold Improvements)	Remainder of Lease Period or 20 Years Whichever Is Less	
Land Rights of Limited Duration	Over the Specified Duration	
TABLE 6-7		
* A recovery period of less than 5 years is permitted when the acquiring DoD Component is certain that the useful life of an asset is at least 2 years but less than 5 years. In such circumstances, the recovery period shall be the known useful life (2-4 years, as appropriate).		
** Depending on the nature of the software, it may be depreciated over a period of less than 5 years, 5 years or 10 years. The determining factor should be the actual estimated useful life of the software consistent with that used for planning the software's acquisition.		

Version 1.0

Preparation for a Real Property Audit

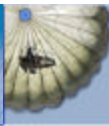
L2-27

Depreciation expenses are calculated and accumulated using the straight-line method based on the recorded cost. They are then divided equally among accounting periods during the asset's useful life based on recovery periods shown in Table 6-7 of the DoDFMR, Volume 4, Chapter 6.

DoDI 4165.14 is currently being updated and will be accepted by the DoD. The useful life of 40/20 will change when the publication is updated.

One caveat occurs if the building, structure, or facility remains in use longer than its estimated useful life. In that case, just retain it in the property accountability or management system, as well as in the accounting records, and continue to report both its recorded cost and accumulated depreciation on the Balance Sheet and Note 10, until its final disposition.

Next let's look at improvements to real property as it relates to CIP valuation.



Construction-in-Progress (cont.)



The costs to improve a real property asset are capitalized when they:

- Increase the building's capacity, size, efficiency, or useful life
- Equal or exceed the DoD capitalization threshold
- Modify the functionality



Improvements are depreciated according to the recovery period shown in the DoDFMR, Volume 4, Chapter 6, Table 6-7.

Version 1.0

Preparation for a Real Property Audit

L2-28

The costs to improve a real property asset are capitalized when they increase the building's capacity, size, efficiency, useful life, or when the functionality is modified. In addition, the cost of an improvement is capitalized only when the cost of the improvement equals or exceeds the DoD capitalization threshold, regardless of funding source. Applicable improvements are capitalized and depreciated separately from the structure being improved. While the SFFAS No. 6 requires improvements to be capitalized and depreciated over the remaining useful life of the associated General PP&E asset, DoD policy recognizes that improvements also are made to assets that are substantially or fully depreciated. Therefore, improvements are depreciated over the standard recovery periods shown in Table 6-7. Improvements that do not increase an asset's capacity, size, efficiency, or useful life, regardless of the cost of the improvement, are expensed. These improvements not only apply to CIP, but they also apply to any improvements.

So what this means is that improvements to General PP&E real property (including multi-use Heritage Assets), that equal or exceed the capitalization threshold of \$100,000, are individually capitalized and recorded in real property accountability or accounting systems and depreciated over the applicable standard recovery period indicated in Table 6-7. Improvements to fences, roads, bridges, sewers, and utilities are also depreciated as provided for in the table.

Next let's examine financial statements implications for construction agents.




Financial Statements Implications for Construction Agents




Army Corps of Engineers (USACE)



Naval Facilities Engineering Command (NAVFAC)

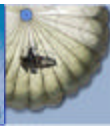


Version 1.0
Preparation for a Real Property Audit
L2-29

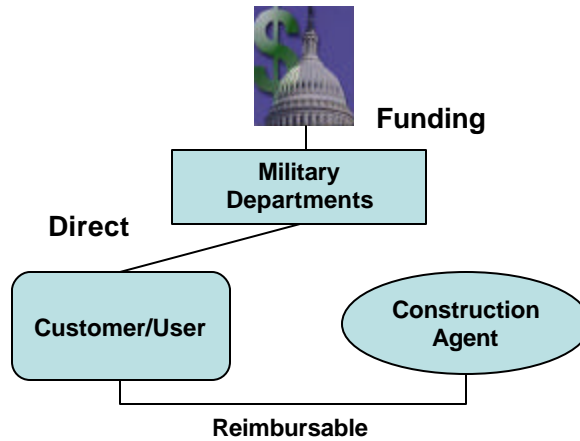
The two primary construction agents for the Department are the USACE and NAVFAC.

USACE supports the military in the U.S. and overseas by designing and managing the construction of homes, schools, hospitals, day care centers, office buildings, airfields, warehouses, and training ranges. They are the world's largest public engineering, design, and construction management agency, and they also buy, manage, and dispose of land for the Army and Air Force. USACE also has a civil works mission that is constantly evolving to keep pace with the changing needs of the nation. Today, that mission includes the four broad areas of water infrastructure, environmental management and restoration, emergency response and assistance, and engineering support and technical services.

NAVFAC primarily provides engineering support for the Navy and Marine Corps, but the Air Force and the Defense Logistics Agency (DLA) are also among their customers. Their mission is to manage the planning, design, construction, contingency engineering, real estate, environmental, and public works support for U.S. Navy shore facilities around the world; and to provide the Navy's forces with the operating, expeditionary, support, and training bases they need. NAVFAC is part of the Navy Working Capital Fund.



Financial Statements Implications for Construction Agents (cont.)



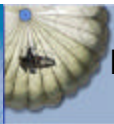
Version 1.0

Preparation for a Real Property Audit

L2-30

Funding may come in the form of direct appropriation or a cost reimbursement process. Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multiyear basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The construction agent recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

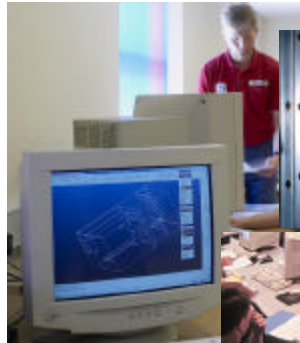
Once the construction agent has the funding and authority to start, cost accumulation begins.



Financial Statements Implications for Construction Agents (cont.)



Cost Accumulation



Direct costs

Indirect costs

**General and
administrative
costs**

From Beginning to End

Version 1.0

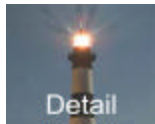
Preparation for a Real Property Audit

L2-31

Construction agents accumulate real property costs in cost/management accounting systems that allow cost visibility of the various inputs to the final product. For example, direct costs are typically defined as costs identifiable with a single specific output. Indirect costs are those traceable to more than one output but not all outputs. An example might be a supervisor who does not perform direct labor and has responsibility for more than one output. Indirect costs are broken down into material and labor categories. The construction agent might also track General and Administrative costs (G&A). These are costs that can't be identified with any specific output but are needed by all outputs. Examples might include janitorial services and headquarters' staff costs.

The costs for building construction are aggregated in the CIP account for each asset. Annually, these costs are transferred to the customer/user as we saw defined in the MOU between NAVFAC and DFAS discussed earlier. And that is really central to this issue. Coordination is imperative to ensure proper recognition that allows only one party to report the costs.

Let's take a closer look at financial statements for construction agents.



Financial Statements Implications for Construction Agents (cont.)



Note 10

Army Consolidated Balance Sheet - Asset Section

Note 10: General PP&E, Net

	2004	2003
1. Major Asset Classes:		
A. Land	NA	NA
B. Buildings, Structures, and Facilities	GA	GA
C. Leasehold Improvements	GA	GA
D. Software	GA	GA
E. General Equipment	GA	GA
F. Military Equipment	GA	GA
G. Assets Under Capital Lease	GA	GA
H. Construction-in-Progress	GA	GA
I. Other	GA	GA
J. Total General PP&E	GA	GA

**Department of Defense-Department of the Army
CONSOLIDATED BALANCE SHEET**
As of September 30, 2004 and 2003 (In Thousands)

	2004 Consolidated	2003 Consolidated
ASSETS (Note 2)		
Intergovernmental:		
Fund Balance with Treasury (Note 3)	\$99,207,373	\$54,695,897
Entity	113,430	278,139
Non-Entity Seized Ineq. Cash	137,806	61,443
Non-Entity Other	1,496	1,231
Investments (Note 4)	461,867	523,347
Accounts Receivable (Note 5)	596,390	83,474
Other Assets (Note 6)	\$99,569,352	\$55,643,511
Total Intergovernmental Assets	\$152,500	\$954,365
Cash and Other Monetary Assets (Note 7)	482,394	514,579
Accounts Receivable (Note 8)	0	0
Loans Receivable (Note 9)	0	0
Inventory and Related Property (Note 10)	13,111,551	32,676,658
General Property, Plant and Equipment (Note 10)	13,111,551	115,337,906
Other Assets (Note 6)	3,251,504	3,989,021
TOTAL ASSETS	\$169,453,818	\$174,972,909

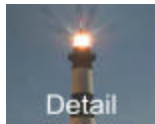
Version 1.0

Preparation for a Real Property Audit

L2-32

Financial statement implications include financing payments. These occur because of the USACE's need to use long-term contracts that provide financing payments for real property based on a percentage of completion basis. This type of payment is treated as CIP and is therefore reported on the General PP&E line and in Note 10, in accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities. On the left of the slide circled in red, Note 10 shows the CIP line and the total accumulated PP&E, which you can then track to the Balance Sheet on the right side in the General PP&E line – both shown as a star burst.

Additionally, based on the FAR, USACE makes financing payments under fixed price contracts that are not based on a percentage of completion. USACE reports these financing payments as advances or prepayments in the Other Assets line item. These are then treated as advances or prepayments because USACE becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, USACE is not obligated to reimburse the contractor for its costs and the contractor is liable to repay USACE for the full amount of the advance. Notice this transaction on the Other Assets line on the Balance Sheet, in the blue rectangle referencing Note 6, which is not shown.



Financial Statements Implications for Construction Agents (cont.)



Coordination is imperative!

Army Consolidated Balance Sheet Asset Section

Department of Defense-Department of the Army CONSOLIDATED BALANCE SHEET <small>As of September 30, 2004 and 2003 (in thousands)</small>		
ASSETS (Note 2)	2004 Consolidated	2003 Consolidated
Intergovernmental:		
Fund Balance with Treasury (Note 3)		
Gifts	\$99,297,373	\$54,896,897
Non-Entity Seized Inv. Cash	113,430	278,139
Non-Entity-Other	137,806	61,643
Investments (Note 4)	1,496	1,231
Accounts Receivable (Note 5)	461,967	523,947
Other Assets (Note 6)	556,380	83,474
Total Intergovernmental Assets	\$99,566,352	\$55,643,531
Cash and Other Monetary Assets (Note 7)	\$1,525,090	\$954,368
Accounts Receivable (Note 8)	492,394	\$14,579
Loans Receivable (Note 9)	0	0
Inventory and Related Property (Note 10)	37,647,721	32,676,658
General Property, Plant and Equipment (Note 10)	113,111,572	115,337,906
Investments (Note 4)	0	0
Other Assets (Note 6)	3,351,506	3,989,023
TOTAL ASSETS	\$245,696,633	\$209,696,063

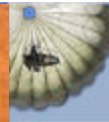
Version 1.0

Preparation for a Real Property Audit

L2-33

Earlier, we said that USACE aggregates the CIP account and reports that balance to the customer by end of the fiscal year. This process is very important in that only one of the entities must report the CIP; otherwise the Balance Sheet is misstated. Although the customer/user is responsible for reporting, during an audit the supporting documentation must be available to support the balances. In accordance with DoDFMR, Volume 4, Chapter 6, 060203 B. 3, such CIP balances shall be provided annually by the USACE and NAVFAC to the appropriate reporting DoD Component along with supporting documentation in sufficient detail to reconcile the CIP balances by project and funding source. In addition, USACE and NAVFAC shall make any additional data available to the reporting DoD Component upon request.

Now let's look at the financial statements implications for users.



Financial Statements Implications for Users



Note 10

Balance Sheet Asset Section

NOTE 10 GENERAL PP&E, NET						
	2015			2014		
Depreciation Amortization Expense	Service Life	Population Value	Accumulated Depreciation Amortization	Net Book Value	Net Book Value	
As of December 31, 2015						
(Amounts in thousands)						
1 Major Asset Intangible						
A. Labels	Indefinite	\$87,000	\$87,000	\$87,000		\$87,000
B. Datalogs, Datalogs/Tr, PCH	Indefinite	\$9,900	\$9,900	\$9,900		\$9,900
C. Intellectual Property	Indefinite	\$24,000	\$24,000	\$24,000		\$24,000
D. Software	Indefinite	\$2,000	\$2,000	\$2,000		\$2,000
E. Patents	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
F. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
G. Customer Relationships	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
H. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
I. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
J. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
K. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
L. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
M. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
N. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
O. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
P. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
Q. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
R. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
S. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
T. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
U. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
V. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
W. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
X. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
Y. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
Z. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AA. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AB. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AC. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AD. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AE. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AF. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AG. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AH. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AI. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AJ. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AK. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AL. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AM. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AN. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AO. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AP. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AQ. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AR. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AS. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AT. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AU. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AV. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AW. Other Identifiable Intangible	Indefinite	\$1,000	\$1,000	\$1,000		\$1,000
AX. Other Identifiable Intangible	Indefinite	\$1,000	\$1,0			

Department of Defense Department of the Navy COMBINED BALANCE SHEET As of September 30, 2004 and 2003 (In Billions)		
	2004 Combined	2003 Combined
	Actual	Revised
ASSETS (Page 2)		
Intangible		
Paid Balance with Treasury (Page 2)	\$	(1,014.0)
Net Equity, Remaining Cash		\$
Non-Equity - Other	219.0	322.2
Intangible (Page 2)	6.4	6.4
Accounts Receivable (Page 2)	(70.7)	46.8
Other Assets (Page 2)	(2.1)	\$
Total Intangible Assets	\$	(770.4)
Cash and Other Monetary Assets (Page 2)	214.8	261.8
Accounts Receivable (Page 2)	(6,006.9)	1,362.4
Assets Requiring Study	\$	\$
Unrecorded and Property (Page 2)	32,364.0	33,671.8
Other Assets (Page 2)	(1,014.0)	984.6
Total Assets	\$	\$
Other Assets (Page 2)	(6,006.9)	6,006.9
LIABILITIES AND EQUITY	\$	\$
TOTAL ASSETS	\$	\$

Version 1.0

Preparation for a Real Property Audit

L2-34

The users we are concerned with are the DoD customers of the construction agents just discussed. Generally, users request funding for the real property construction project and coordinate with the construction agent to acquire it on the required schedule. Once construction begins, the construction agent accumulates costs in the CIP account that are reported to the user annually and upon completion of the project. The user reports the results in Note 10 and the Balance Sheet, as shown on these consolidated Navy statements.

One of the most critical points in this process is to ensure that only one entity is recognizing and reporting the results.



Financial Statements Implications for Users (cont.)



Disposal of Real Property

For BRAC:

- Remove from PP&E account
- Record in Other Gen PP&E account at NRV
- When NRV is zero, record gain or loss

Note 10. General PP&E, Net						
As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	2-5 Or 10	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9

Note 10 to the Department's Combined Statements

Version 1.0

Preparation for a Real Property Audit

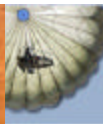
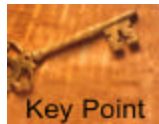
L2-35

Determine the disposal start date of the obligation document to complete the disposal action or the date the operation ceased, whichever is later. On that date, the asset is no longer depreciated, its book value removed from the financial records, and the corresponding gain/loss is recorded on the financial statements.

When you, as title holder, identify real property for permanent removal from service because it no longer contributes to the operation of your Component, you cease reporting depreciation on Note 10 and the Balance Sheet. These normal disposal transactions are accounted by using the SGL Account 5730, Financial Resources Transferred Out Without Reimbursement.

However, for real property removed from service for Base Realignment and Closure (BRAC), the real property is removed from the PP&E accounts along with any associated depreciation. These transactions are then recorded in the Other General PP&E account, SGL Account 1890, at the net realizable value (NRV). Often the NRV is zero, in which case the difference between the book value of the real property and its expected NRV is recognized as a gain or loss in the period of adjustment. When the installation's mission is terminated or transferred because of BRAC, the real property is removed from the PP&E accounts along with the associated accumulated depreciation. These too are recorded in the Other General PP&E account at the NRV.

On a related note, for real property temporarily removed from service that you expect to eventually return to service, just continue to depreciate it during the periods of non-use.



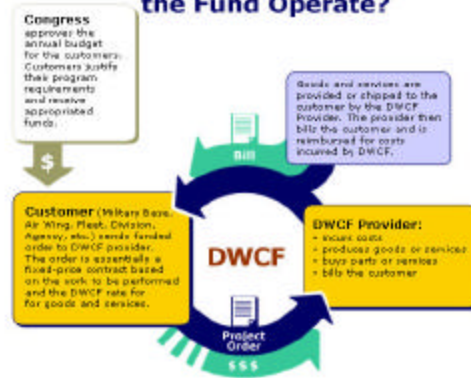
Working Capital Fund Business Rules



Defense Working Capital Fund (DWCF) consists of:

- Defense-wide
- Army
- Navy
- Air Force
- Defense Commissary Agency (DeCA)

How Does the Fund Operate?



Source: OUSD(C) iCenter

Version 1.0

Preparation for a Real Property Audit

L2-36

To understand how to account for real property exceptions, let's understand how a WCF operates.

Congress approves funding to the customer who places orders with the WCF provider. The provider is reimbursed by the customer so that all the provider's costs are recouped. This is accomplished by establishing a rate structure that accomplishes full reimbursement.

The DWCF actually consists of working capital funds for the Army, Navy, Air Force, and Defense-wide, plus the Defense Commissary Agency (DeCA). The DWCF's functions are divided into business areas consisting of supply, depot maintenance, and transportation that provide goods and services both within the Department and to authorized non-DoD activities.

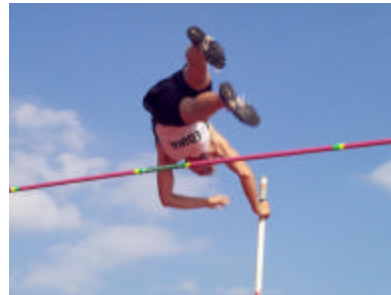
Next let's examine how to account for real property exceptions.



Working Capital Fund Business Rules (cont.)



Even though the bar was raised, real property capitalized at lower thresholds remains capitalized in the WCF.



WCF business rules: all real property that contributes to its mission is classified as General PP&E.

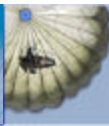
Version 1.0

Preparation for a Real Property Audit

L2-37

The first accounting exception we examine resulted from a change in policy as to the capitalization threshold. We learned earlier that the Department's threshold is \$100,000 but that prior to FY 1996, it had been set at lower amounts. Business rules for WCF activities allowed assets capitalized under those lower thresholds to remain on the Balance Sheets for WCF activities while they have to be written off for general fund activities.

Another business rule applies to WCFs regarding the classification of real property. Unlike general fund activities, all WCF real property that contributes to its mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E category.



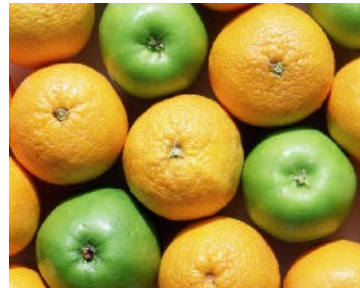
Working Capital Fund Business Rules (cont.)



Real property depreciation amounts used for rate development may differ from those used in financial statement reporting.

Depreciation affects the:

- **Statement of Net Cost**
- **Balance Sheet**
- **Statement of Changes in Net Position**



Version 1.0

Preparation for a Real Property Audit

L2-38

Special rules for WCF activities also include the requirement to recognize and depreciate real property regardless of how it was purchased or whether the depreciation is included in customer rates. You should note that because it may or may not be in the customer rates, depreciation for rate development and depreciation for the financial statements can be as different as apples and oranges.

As depreciation is entered into the financial statements, it is treated as an expense on the annual Statement of Net Cost and it is shown in accumulated depreciation amounts on the Balance Sheet. The depreciation is also reported in the monthly Report on Budget Execution, Accounting Report (AR) (Monthly) (M) 1307 and reflected in the Statement of Changes in Net Position.

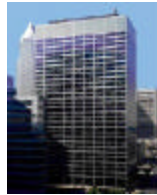
To recap, the Consolidated Statement of Net Cost represents the net cost of the Department's operations, and the Consolidated Balance Sheet contains those resources owned or managed by the Department, less amounts owed and the difference between the two. This is better known as the accounting equation where assets minus liabilities equals net position. The Consolidated Statement of Changes in Net Position reflects basically just that, the change in the Department's net position.



Working Capital Fund Business Rules (cont.)



Preponderant Use and Real Property Capital Improvements



WCF activities generally report and depreciate real property they use – this includes improvements too!

Source: FMR Vol. 4, Chap. 6, para. 060105B.

Version 1.0

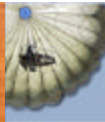
Preparation for a Real Property Audit

L2-39

We just said that a WCF recognizes and depreciates real property regardless of how it was purchased. This means buildings used by a WCF activity may not have been constructed or acquired with WCF funds. However, they should generally be capitalized and depreciated by the WCF activity and reported on the WCF activity's annual financial statements. Such accounting and reporting is required by WCF activities regardless of whether title to such buildings is passed to the local installation when construction is completed.

When a building is occupied by more than one component, business rules apply as to who must report and depreciate the building. This rule specifically applies to capital improvements. Whether or not a WCF activity is the preponderant user of a facility, they report and depreciate it on their annual financial statements. This is also true for capital improvements, whether or not the WCF is the preponderant user of the facility improved. An example is drawn by the DFAS and Navy occupying the same building. Regardless of whether DFAS has the smaller portion of the facility, when they make a capital improvement, the improvement is recorded in the applicable property records, and DFAS reports and depreciates the improvement on its financial statements. Again, notice that this refers to those real property improvements that meet the Department's capitalization threshold.

Let's now discuss how to identify supporting documentation.



Using the Checklist to Identify Supporting Documentation



The numbers on the financial statements must be provable – supporting documentation is that proof!

What documentation do you use that supports the financial statements?

Version 1.0

Preparation for a Real Property Audit

L2-40

This topic discusses how to identify supporting documentation by using a checklist.

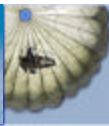
Can you imagine the size this checklist must be to cover every circumstance for real property within the entire Department?

You can develop your own personalized checklist, better suited to your specific needs.

Before the question you see on the slide is presented, maybe the following question should be asked, "What is supporting documentation?"

The bottom line is that the numbers on the financial statements must be provable, and supporting documentation is that proof. Every entry to record a financial transaction requires supporting documentation. Each must be supported by source documents that reflect the Component's investment in the real property.

Let's look at creating a checklist.



Using the Checklist to Identify Supporting Documentation (cont.)



Checklist development:

- **Review Prepared by Client (PBC) list**
- **Flowchart the audit trail**

The DoDFMR requires that adequate documentation be maintained for an effective audit trail.

Version 1.0

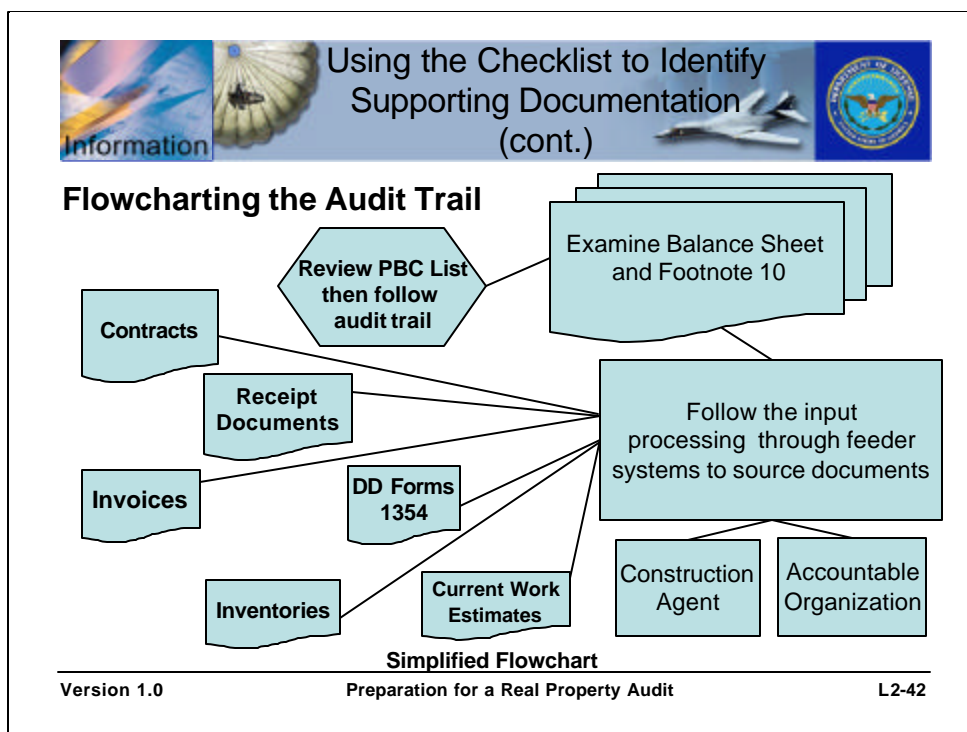
Preparation for a Real Property Audit

L2-41

To build a checklist, we need to establish the documents you use and where they are located. You may want to start by reviewing previous PBC lists if available. The PBC list is initially prepared by the audit team and provided to the audited entity identifying the auditor's requirements including due dates. The list is used to facilitate the audit process by ensuring coordination with those points of contact the audit team determined they need to see. This includes hard copy documentation, systems, places, people; basically everything that touches the audit trail should be available and ready. Real property should be tested for existence and completeness at the site long before the auditors arrive.

Another tool that can assist you is a flowchart designed to follow the audit trail of the various documents. As you know, often the document that creates the accounting event is originated by functions outside of accounting. An audit trail is the link that connects the financial statements to the originating documentation or input, and they must be re-traceable.

The DoDFMR says a key test of the adequacy of an audit trail is whether tracing the transaction forward or backward will permit verification of the amount recorded or reported. This is an important concept because the audit trail documents the processing of source transactions into feeder systems, through the accounting system, as reflected in the financial statements.

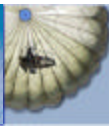


This example of a simplified flowchart gives you the idea of what you need to do to locate and document supporting documentation.

When supporting documents are no longer on file, estimates must be made. Estimates should include the cost of the real property and its accumulated depreciation. The main point to remember here is that your effort to achieve an accurate estimate should be proportionate to the materiality and relative significance of the real property. The method of estimation and all details are important documentation to support the cost estimate.

Acceptable procedures for valuing real property for which historical cost documentation does not exist include current working estimates prepared for acquisition, appropriation or other Congressional information, Plant Replacement and Improvement Program documentation, development of an estimate based on the cost of similar assets at the time of original acquisition, and current cost of similar assets discounted for inflation since the time of acquisition.

The construction agent (USACE or the NAVFAC) should both have copies of supporting documentation for the project and provide the reporting entity with the supporting documentation on an annual basis and upon request. The accountable organization is responsible for accounting for the information from the USACE or NAVFAC on their financial statements in their CIP account.



Using the Checklist to Identify Supporting Documentation (cont.)



Real property office supporting documentation:

- **Begins with acceptance of custody**
- **Follows the real property disposed of or transferred**
- **Is retained by the losing Component as a backup copy**

<http://www.dod.mil/comptroller/fmr/>

Version 1.0

Preparation for a Real Property Audit

L2-43

Once you've completed identifying the documentation that supports your real property, you can begin to develop the actual checklist. Your checklist may examine supporting documentation related to property management, acquisition, receiving, identification, consumption, utilization, movement, storage, physical inventory, maintenance, and disposition. This effort may be part of your Component's internal control activities.

Control activities should occur at all levels of an entity and include a whole range of activities, such as approvals, authorizations, verifications, reconciliations, performance reviews, security, and the creation and maintenance of appropriate documentation. Documents must support all acquisitions, regardless of whether they were purchased, transferred from another agency, or donated. The key to when supporting documentation must be on hand is the date the Component takes custody of the real property.

The actual acquisition documents, or electronic copies, are retained by the Component in accordance with Volume 1, Chapter 9, of the DoDFMR. They have to be in a location that is easy to find in order to permit validation of certain real property information, such as the acquisition cost, acquisition date, and the cost of improvements. Some examples of supporting documentation are purchase invoices, sales and procurement contracts, DD Form 1354 (Transfer and Acceptance of Military Real Property), ENG Form 3013 (Work Order/Completion Report), construction contracts, and work orders.

If real property is disposed of or is retired, the supporting documentation must accompany the asset. When it transfers to another activity, copies of the supporting documentation are also transferred to the other activity. When General PP&E assets are transferred, traded, sold, or disposed through salvage or demolition, the copies of the original acquisition documents and the disposal documents are retained.

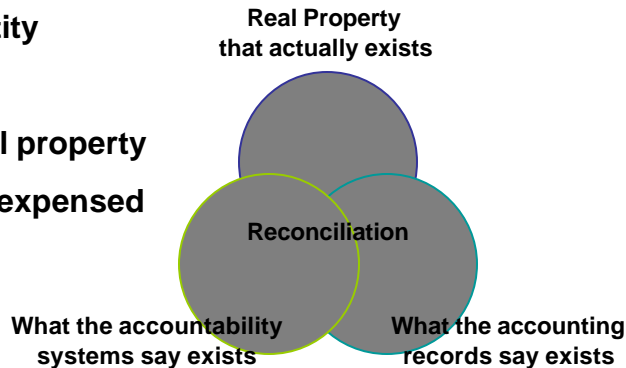


Using the Checklist to Identify Supporting Documentation (cont.)



Real property checklist items:

- **Physical quantity**
- **Location**
- **Cost of the real property**
- **Capitalized or expensed**
- **Same records**



Version 1.0

Preparation for a Real Property Audit

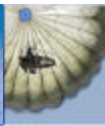
L2-44

The checklist will allow for a periodic, independent verification of the accuracy of the accounting and accountability records through periodic physical counts or inventories of real property. This is to ensure its existence and completeness, as in a book to floor and floor to book reconciliation of the subsidiary property accountability records and/or systems with the general ledger accounts and physical accounts. The reconciliation of these three pieces is an integral theme to your checklist development. Specific checklist items should verify that documentation includes sufficient information about the physical quantity, location, and cost of the real property.

One area that continues to cause problems is the improper recording of real property – that is, the mistreatment of capitalized and expensed assets. Your checklist should identify and classify real property that was capitalized, recorded in the property accountability or accounting system, and reported in annual financial statements. It is also important to expense real property that does not meet the capitalization threshold. These items are still recorded in property accountability records or systems for control purposes when they cost at least \$5000, per DoDI 5000.64.

A checklist item to ensure the costs of construction projects accumulate properly is essential. Costs should either reflect in the CIP account or a subsidiary system for posting to the applicable real property accounts when construction is completed. For projects that are terminated prior to construction, the costs should reflect in the appropriate expense accounts.

Your checklist should verify the same documents are used to create the accounting and accountability records. This will ensure that the property accountability records are integrated and subsidiary to the accounting system, and that accountability records can be reconciled with the accounting system.



Using the Checklist to Identify Supporting Documentation (cont.)



Real property checklist items (cont.):

- **Held by others**
- **Held by Military Departments through seizure, forfeiture, loss, or abandonment**
- **Leased**
- **Capital improvements**
- **Adjustments**

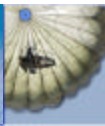
Version 1.0

Preparation for a Real Property Audit

L2-45

Your checklist should include verification of all Military Department-owned real property (including property held by others) and that of others held by the Department through seizure, forfeiture, loss, or abandonment. You will want to provide information to identify and account for leased and real property. Your checklist should also provide information to identify and account for capitalized additions and improvements to real property.

The supporting documentation checklist should examine the consequences of adjustments by carefully validating adequate support to the adjustment. What is needed is written documentation that is sufficiently detailed so that it provides an audit trail to the source that requires the adjustment. This documentation ought to include the rationale and justification for the adjustment, detailed numbers and dollar amounts of errors or conditions that are related to the transaction or record that are proposed for adjustment, the date of the adjustment, and the name and position of the individual approving the adjustment. This is an area that is apt to cause problems as it is not a routine event and care should be given to verification of supporting documentation.



Using the Checklist to Identify Supporting Documentation (cont.)



Other checklist support:

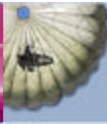
- **DoDFMR, Volume 6B, Appendix B, Reconciliation Requirements for the Annual Financial Statements**
- **Financial Audit Manual, Checklist for Federal Accounting and Disclosures at <http://www.gao.gov/special.pubs/01765G/>**

Reconciliation doesn't necessarily mean that amounts must agree. The key is knowing what the differences are and having supporting documentation.

The DoDFMR reference is one source to help you reconcile the annual financial statements internally, like line items on the Balance Sheet to other Balance Sheet line items, or Balance Sheet to Statement of Changes in Net Position. Appendix B in the FMR also shows the reconciliations between the annual financial statements and the Report on Budget Execution, the AR (M) 1307, and the DD Form 725, Report on Reimbursements.

The FAM contains an abundance of checklists and insight as to how the auditors look at various aspects of your operation. The Checklist for Federal Accounting and Disclosures is one source that examines the Balance Sheet and other statements. Your review of this document will be helpful to your full development of a personal real property supporting documentation checklist.

Let's review key topics presented in this lesson.



Lesson Summary



- **Real Property Recording**
- **Preponderant Use**
- **CIP**
- **Construction Agents and Users**
- **WCF Business Rules**
- **Supporting Documentation Checklist**

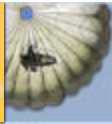
Version 1.0

Preparation for a Real Property Audit

L2-47

In this lesson, you learned that valuation is the process of determining the worth of real property and some methods for doing it. We discussed preponderant use rules governing Military Departments' cross-utilization of real property, rules for other Components, and business rules for medical facilities. Significant time was given to understand the CIP process from several points of view, including the builder, the transfer process, and the recipient. Construction agents and the user were examined with emphasis on their activities' impact on the financial statements. You also learned the business rules for applying valuation to WCFs. We ended the lesson by learning to develop a checklist to help identify all the supporting documentation required for a successful audit of the real property area.

The following slide list references available for additional information.

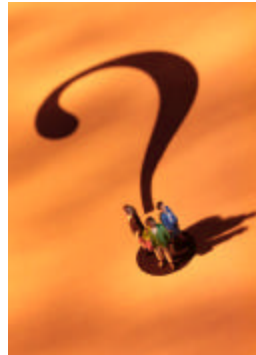


References



DoDFMR: <http://www.dod.mil/comptroller/fmr/>

FAM: <http://www.gao.gov/special.pubs/01765G/>



Version 1.0

Preparation for a Real Property Audit

L2-49

Do you have any questions on the material covered in this lesson?

This page intentionally left blank.

Review 2. Real Property Process Practice Exercise

Directions This is an open-book practice exercise to assess your knowledge of Lesson 2, Recording and Validating Real Property. There is one problem contained in this exercise which is followed by questions. Review the problem and answer the questions.

Time Allocation The time allocated to this practice exercise is 15 minutes: 10 minutes for the exercise and 5 minutes for the review and discussion.

Problem During a recent inventory of Real Property, the property officer identified a building that initially was a Construction in Progress (CIP) and was not accounted for on property records.

The dollar amount of the building is \$4,000,000.

Based on the information provided and the lesson presentation, answer the following questions.

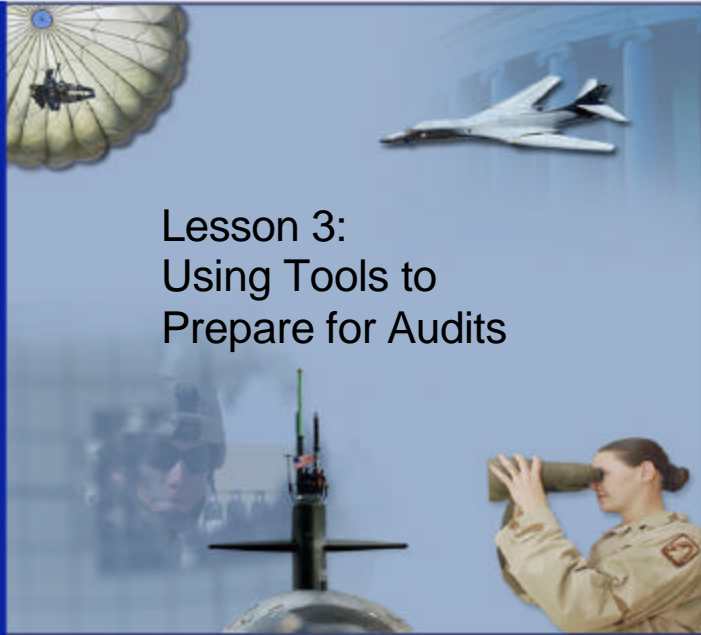
Number	Question
1	What two activities provide CIP for Military Departments?
2	What is the DoD capitalization threshold?
3	What financial statement and related note will the property eventually appear?
4	If this transaction was processed correctly, what form would have been used to transfer the building and related information to the Military Department?

This page intentionally left blank.

Preparation
for a Real
Property
Audit



Lesson 3:
Using Tools to
Prepare for Audits



In this lesson, we will describe and explain what tools are available to achieve audit compliance.

Let's discuss the lesson objectives.



Upon successful completion of this lesson, you will be able to:

- **Identify current regulatory guidance**
- **Describe how to apply real property business rules**
- **Explain how to prepare for the assertion process**
- **Recognize applicable checklists and measurements for audits**

Version 1.0

Preparation for a Real Property Audit

L3-2

To achieve an unqualified opinion on your annual audited financial statements, you need to understand tools such as regulatory guidance, business rules, assertion preparation, checklists, and performance measurements that are useful in preparation for real property audits.

With an understanding of the purpose and value of financial statements audits, you need to know the tools that are available for achieving an unqualified opinion.

Let's look at the lesson topics.



Lesson Topics



This lesson contains the following topics:

- **Legislative and Regulatory Requirements**
- **FAM and GAO Yellow Book**
- **Internal Control**
- **Rules for Real Property**

Version 1.0

Preparation for a Real Property Audit

L3-3

These are the topics in this lesson. We will discuss the laws and regulatory requirements for preparing for a real property audit, and the federal agencies that provide regulatory guidance for the Department to follow, such as the Office of Management and Budget (OMB) and the Government Accountability Office (GAO).

You will become familiar with how to implement internal control and Standard Operating Procedures (SOPs), and how to disseminate and communicate information within the Department of Defense (DoD).

You will learn how the business rules apply to real property.

Let's look at some more lesson topics.



Lesson Topics (cont.)



This lesson contains the following topics:

- **Roles and Responsibilities**
- **Discovery and Correction**
- **Validation**
- **Assertion**
- **Assessment**
- **Audit**
- **Establishing Accountability**

Version 1.0

Preparation for a Real Property Audit

L3-4

Also in this lesson, you will learn the roles and responsibilities of the auditor, auditee, managers, Defense Finance and Accounting Service (DFAS), and services during the audit.

We then discuss the different phases of the business rules (Discovery and Correction, Validation, Assertion, Assessment, and Audit) as they relate to real property.

You will also learn about establishing accountability, and other performance measures.

Let's talk about some legal and regulatory guidance, as it applies to real property.



Legislative and Regulatory Requirements



- **Government Performance and Results Act**
- **Office of Management and Budget Circular A-11**
- **Chief Financial Officers Act**
- **Government Management Reform Act**
- **Federal Managers Financial Integrity Act**
- **Federal Financial Management Improvement Act**
- **Clinger Cohen Act**
- **President's Management Agenda**
- **Government Accountability Office**

Version 1.0

Preparation for a Real Property Audit

L3-5

While preparing for a real property audit, you must be knowledgeable of some of the laws and regulatory guidance.

The guidance includes:

- requirements to develop strategic plans, set performance goals , and report annually on actual performance compared to goals
- requirements for agencies to establish and assess internal control related to financial reporting
- requirements for agencies to have financial management systems that substantially comply with the federal financial management systems requirements, the standards promulgated by the Financial Accounting Standards Board (FASAB), and the United States Standard General Ledger (USSGL), at the transaction level
- definitions of management's responsibility for internal control in federal agencies
- establishing standards for auditor's responsibilities; establishing property management systems requirements; ensuring financial statements audits achieve their intended outcome; and establishing guidance for auditors in evaluating internal control of data in financial management systems.

Let's look at the Government Performance and Results Act (GPRA).



Legislative and Regulatory Requirements (cont.)



Government Performance and Results Act (GPRA)

- **Established standards for performance**
- **Defined missions and desired outcomes**
- **Prepared strategic plans and annual performance plans and reports**
- **Measured performance in terms of inputs, outputs, and outcomes**
- **Used performance data to improve processes, identify performance gaps, and set performance goals**

<http://www.whitehouse.gov/omb/mgmt-gpra/gplaw2m.html>

Version 1.0

Preparation for a Real Property Audit

L3-6

The GPRA resulted from Congress finding:

- waste and inefficiency in federal programs
- insufficient articulation of program goals and subsequent information on program performance
- Congressional policy making, spending decisions, and program oversight seriously handicapped by insufficient attention to program performance and results.

The act requires agencies to initiate program performance reforms with a series of pilot projects in setting program goals, and measuring program performance against those goals, and reporting publicly on their progress. It directs agencies to improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction.

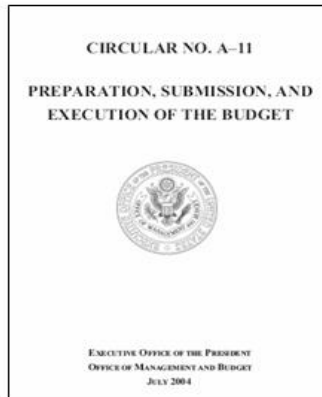
Let's talk about OMB Circular A-11.



Legislative and Regulatory Requirements (cont.)



Office of Management and Budget Circular A-11



<http://www.whitehouse.gov/omb/circulars/a11/04toc.html>

Version 1.0

Preparation for a Real Property Audit

L3-7

Part of the OMB's mission is to ensure that agency plans and reports are consistent with the President's budget and administration policies.

The GPRA requires OMB to prepare a government-wide performance plan based on the agency's performance plan. To improve the quality and consistency of the performance plans, the OMB issues annual guidance on format, required elements, and submission deadlines.

OMB Circular A-11 requires agencies to use consistent methodology such as life-cycle costing, earned value management, and capital planning to control costs associated with acquiring, managing, and maintaining an information technology enterprise.

Let's discuss the Chief Financial Officers (CFO) Act.



Legislative and Regulatory Requirements (cont.)



Chief Financial Officers (CFO) Act

- **Designated a Chief Financial Officer position**
- **Prepared annual, auditable financial statements**
- **Improved accounting systems, financial management, and internal control**
- **Provided complete, reliable, timely, and consistent financial information**

<http://www.oirm.nih.gov/itmra/cfoact.html>

Version 1.0

Preparation for a Real Property Audit

L3-8

The Chief Financial Officers Act was enacted by Congress to:

- bring more effective general and financial management practices to the government
- provide for improvement of accounting systems, financial management, and internal control
- provide complete, reliable, timely, and consistent financial information.

The Chief Financial Officer of the Department is responsible among other things for:

- overseeing all financial management activities for the Department
- developing and maintaining an accounting and financial management system
- complying with applicable accounting principles, standards, requirements, and internal control standards
- complying with policies and requirements as prescribed by the OMB
- providing complete, reliable, consistent, and timely financial information
- preparing and transmitting an annual report to the agency head and the Director, OMB.

Let's talk about the Government Management Reform Act (GMRA).



Legislative and Regulatory Requirements (cont.)



Government Management Reform Act (GMRA)

- **Enacted to improve the efficiency of the Executive Branch**
- **Applied the CFO Act to all DoD Components**
- **Required the government to consolidate all agency financial statements**

http://www.whitehouse.gov/omb/financial/offm_legislation.html

Version 1.0

Preparation for a Real Property Audit

L3-9

The GMRA is a companion act to the CFO Act. Some of the benefits realized by implementing the GMRA include a reduction of inaccurate financial data and the establishment of DoD financial integrity. The GMRA expanded the CFO Act to apply to the 24 major agencies and their Components or sub-agencies.

Let's talk about the Federal Managers Financial Integrity Act (FMFIA).



Legislative and Regulatory Requirements (cont.)



Federal Managers Financial Integrity Act (FMFIA)

- **Obligations and costs are in compliance with applicable laws**
- **Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation**
- **Revenues and expenditures applicable to agency operations are properly recorded and accounted for**

<http://www.whitehouse.gov/omb/financial/print/fmfia1982.html>

Version 1.0

Preparation for a Real Property Audit

L3-10

The FMFIA amended the Accounting and Auditing Act of 1950 to require ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency.

The amendment added a new subsection to ensure compliance with the requirements regarding obligations and cost; funds, property, and other assets are safeguarded; and revenues and expenditures are properly recorded and accounted for to permit reliable reporting of assets.

Let's move on and discuss the Federal Financial Management Improvement Act (FFMIA).



Legislative and Regulatory Requirements (cont.)



Federal Financial Management Improvement Act (FFMIA)

- **Implement and maintain financial systems that comply with federal financial management systems requirements, applicable federal accounting standards, and United States Standard General Ledger (USSGL) at the transaction level**
- **Determine the compliance of systems and a business case before investment in information technology**

http://www.whitehouse.gov/omb/financial/ffs_ffmia.html

Version 1.0

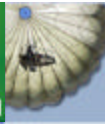
Preparation for a Real Property Audit

L3-11

The FFMIA builds upon and complements the CFO Act and the GMRA. The legislation speaks to the form and content of the financial information produced by federal agencies. It also addresses the system or process used in the production of this information.

The FFMIA requires the federal financial management systems to use the United States Standard General Ledger (USSGL) at the transaction level.

Let's talk about the Clinger Cohen Act.



Legislative and Regulatory Requirements (cont.)



Clinger Cohen Act

- **Established the Office of the Chief Information Officer (CIO)**
- **Required full integration of accounting systems and functional systems**
- **Mandated that the CFO and the CIO work together to develop integrated financial management and asset management systems**

<http://irm.cit.nih.gov/policy/itmra.html>

Version 1.0

Preparation for a Real Property Audit

L3-12

The Clinger Cohen Act (formally the Information Technology Management Reform Act) requires that the government information technology shop operate as an efficient and profitable business operates.

The acquiring, planning, and managing of information technology is treated as a capital investment.

Let's move on and discuss the President's message and the President's Management Agenda (PMA).



Legislative and Regulatory Requirements (cont.)



President's Message

"I am pleased to send to the Congress a bold strategy for improving the management and performance of the federal government. Government likes to begin things – to declare grand new programs and causes. But good beginnings are not the measure of success. What matters in the end is completion. Performance. Results. Not just making promises, but making good on promises. In my administration, that will be the standard from the farthest regional office of government to the highest office in the land."

George W. Bush

Version 1.0

Preparation for a Real Property Audit

L3-13

This is the President's message when The PMA for Fiscal Year (FY) 2002 was sent to Congress. His message outlines the need to reform the government's business practices in order to reduce its vulnerability to fraud, waste, and abuse.

Let's move on and discuss the PMA.



Legislative and Regulatory Requirements (cont.)



President's Management Agenda

- **Improving financial performance**
- **Integrating budget and performance**
- **Managing human capital strategically**
- **Expanding electronic government**
- **Competitive sourcing**

<http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>

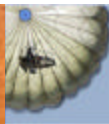
Version 1.0

Preparation for a Real Property Audit

L3-14

The PMA, established by President George W. Bush, is designed to drive improvements in key aspects of government operations and make agencies accountable for their results. The PMA focuses on five areas of management weaknesses across the government that involve financial management and the use of financial information for performance improvement.

Let's look at the Government Accountability Office (GAO).



FAM and GAO Yellow Book



Government Accountability Office (GAO)

The GAO is an agency that works for Congress and the American people.

<http://www.gao.gov/index.html>

Version 1.0

Preparation for a Real Property Audit

L3-15

Under recently passed legislation, the GAO's name was changed to the Government Accountability Office. Congress requests that the GAO study programs and expenditures of the federal government.

The GAO, commonly called the investigative arm of Congress or the Congressional watchdog, is an independent and nonpartisan organization. The GAO studies how the federal government spends taxpayer dollars and advises Congress and the heads of the executive agencies about ways to make government more effective and responsive.

The GAO evaluates federal programs, audits federal expenditures, and issues legal opinions. When GAO reports to Congress, it recommends actions. Its work leads to laws and acts that improve government operations and save billions of dollars.

We will discuss more about specific guidance for the GAO later in this lesson. Let's move on and talk about the Financial Audit Manual (FAM).



FAM and GAO Yellow Book (cont.)



GAO/President's Council on Integrity and Efficiency (GAO/PCIE) Financial Audit Manual (FAM)

- **Volume 1 – Methodology**
- **Volume 2 – Tools**
- **GAO-04-1015G – FAM Update**
- **GAO-04-942G – FAM Update – Checklist for Federal Accounting, Reporting, and Disclosure**

<http://www.gao.gov/special.pubs/gaopcie/>

Version 1.0

Preparation for a Real Property Audit

L3-16

The GAO/President's Council on Integrity and Efficiency (PCIE) FAM provides guidance for performing financial statements audits of federal entities. This is a key tool for enhancing accountability over taxpayer-provided resources. With the passage of the GMRA, Executive Branch Inspector Generals (IGs) and GAO gained statutory responsibility for auditing agency and government-wide consolidated financial statements, respectively. We will discuss the FAM in more detail during the Validation Phase.

The GAO and PCIE have worked together to ensure that these audits are of the highest possible quality, consistent, and cost-effective. The FAM is a result of that cooperation. The GAO/PCIE FAM consists of two volumes including the two July 2004 updates. Volume 1, Methodology, includes four phases: planning, internal control, testing, and reporting. Volume 2, Tools, includes planning and general, internal control, compliance, substantive testing, and reporting.

The July 2004 updates include:

- GAO-04-1015G FAM, which incorporates the provisions of Auditing Standard 99, Consideration of Fraud in a Financial Statement Audit
- GAO-04-942-G FAM, in which the GAO revised the Checklist for Reports Prepared Under the CFO Act (CFO Checklist).

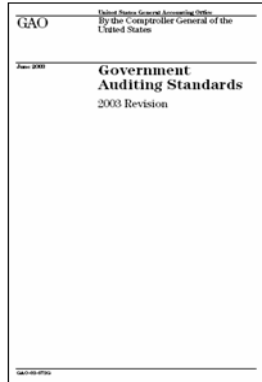
Let's talk about GAO standards.



FAM and GAO Yellow Book (cont.)



Government Auditing Standards



<http://www.gao.gov/govaud/ybk01.htm>

Version 1.0

Preparation for a Real Property Audit

L3-17

The GAO publishes the Government Auditing Standards. The standards provide an overall framework for ensuring that auditors have the competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work. This publication contains information on:

- types of government audits and attestation engagements
- general standards
- field work standards for financial audits
- reporting standards for financial audits
- general, field work, and reporting standards for attestation engagements
- field work standards for performance audits
- reporting standards for performance audits.

Now we have talked about the GAO auditing standards, let's discuss five GAO standards for internal control.



FAM and GAO Yellow Book (cont.)



Five Standards for Internal Control

- **Control environment**
- **Risk assessment**
- **Control activities**
- **Information and communications**
- **Monitoring**

Version 1.0

Preparation for a Real Property Audit

L3-18

The GAO issued standards for internal control under the authority of the FMFIA. These standards are the minimum acceptable level of quality and the basis for evaluating internal control. These standards are the heart of any internal control program.

Control environment pertains to management's integrity and ethical values; commitment to competence; philosophy and operating style; organization structure; delegation of authority and responsibility, human capital policies and practices; and relationship to Congress and oversight agencies.

Risk assessment identifies clear goals and objectives for an organization. The organization identifies and analyzes potential risks.

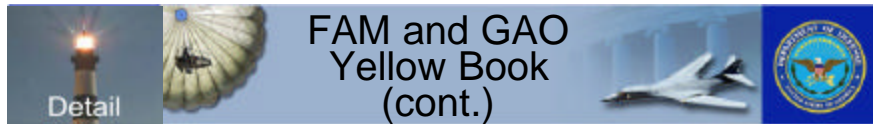
Control activities deal with policies, procedures, techniques, and mechanisms that occur at all levels and functions.

Information and communications relates to the organization having relevant and reliable financial information.

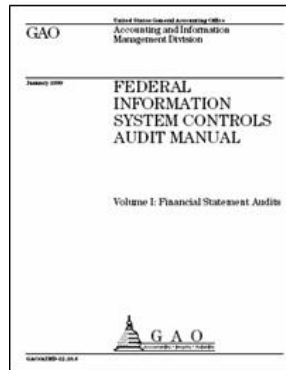
Monitoring includes ongoing reviews of managements internal control responsibilities; separate evaluations, like self-assessments of internal control; and establishing policies and procedures to identify and resolve weaknesses in audit findings.

In addition, the organization should determine whether the strategic plans and accountability goals are met. The organization must have effective communications that flow freely down, across, and up the chain of command.

Let's discuss the GAO Federal Information System Controls Audit Manual.



GAO Federal Information System Controls Audit Manual (FISCAM)



<http://www.gao.gov/special.pubs/ai12.19.6.pdf>

Version 1.0

Preparation for a Real Property Audit

L3-19

The GAO publishes the Federal Information System Controls Audit Manual (FISCAM). This publication is used to assist auditors in reviewing internal control as part of financial statement audits.

This is a companion to GAO/PCIE FAM and contains information on control objectives that auditors should consider when assessing computer-related controls.

The audit manual is a guide used by the GAO primarily in support of financial statement audits and is available for use by other government auditors.

Let's talk about guidance for internal control.



Internal Control



Laws and Guidance for Internal Control

- **FMFIA**
- **OMB Circular A-123**
- **GAO Standards for Internal Control in the Federal Government**
- **Management Control Program Procedures, DoD Instruction (DoDI) 5010.40**

Version 1.0

Preparation for a Real Property Audit

L3-20

Because of the lack and inconsistency of good internal control within the government, Congress, OMB, GAO, and DoD provided guidance to establish good internal control. Let's examine some of that guidance.

The FMFIA required federal agencies to establish internal control programs. As part of this implementation, the OMB issued OMB Circular A-123 providing specific requirements for assessing and reporting on internal control. The GAO was tasked under the FMFIA to create standards for internal control within the federal government.

The DoD implemented DoD Instruction (DoDI) 5010.40, DoD Management Control Program Procedures, which assigns policies, procedures, and responsibilities defined in DoD Directive (DoDD) 5010.38, Management Control Program.

These laws and guidance for internal control represent a top-to-bottom approach. When these procedures are disseminated and then communicated to lower levels, SOPs are established.

Let's discuss the OMB Circular A-123.



Internal Control (cont.)



The Office of Management and Budget Circular A-123

- **Establishing cost-effective management controls**
- **Providing adequate management controls**
- **Identifying needed improvements**
- **Taking corrective actions**
- **Reporting annually on management controls**

<http://www.whitehouse.gov/omb/circulars/a123/a123.html>

Version 1.0

Preparation for a Real Property Audit

L3-21

The OMB issued A-123 under the authority of the FMFIA. This publication contains guidance for federal managers on improving accountability and effectiveness of federal programs. The circular requires agencies to:

- develop and implement appropriate cost-effective management controls for results-oriented management
- assess the adequacy of management controls in programs and operations
- identify needed improvements
- take corrective action
- report annually on management controls.

Circular A-123 discusses internal control. This control is used in an organization to establish policies and procedures and to assist in achieving desired results and safeguard the integrity of their programs. Again, from this guidance, SOPs are established at a lower level by management.

Let's move on and discuss DoDI 5010.40, Management Control Program Procedures.

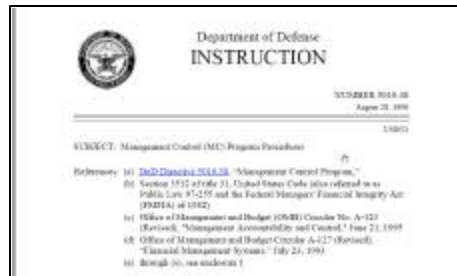


Internal Control (cont.)



Management Control Program Procedures, DoDI 5010.40

- **Management control programs**
- **Annual statement of assurance**



Version 1.0

Preparation for a Real Property Audit

L3-22

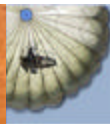
DoDI 5010.40, Management Control Program Procedures, establishes the policy, assigns responsibilities, and prescribes procedures found in the DoDD 5010.38, Management Control Program, FMFIA, and OMB Circular A-123.

In accordance with DoDD 5010.38, the departments will establish a management control program, take action to identify and correct ineffective management controls, and establish new ones when needed.

DoD Components are required to maintain their management control programs and report on their effectiveness.

Components are required to submit in their annual program's Statement of Assurance the effectiveness of their internal control. The Statement of Assurance also includes material weaknesses and their proposed corrective action plan. These Statements of Assurance are signed by the head of the DoD Component and submitted to the Secretary of Defense annually.

Let's discuss some information that is included in an SOP.



Rules for Real Property



SOPs establish:

- **Guidance in accordance with applicable laws**
- **Accountability for assets**
- **Uniform procedures**
- **Responsibilities**

Version 1.0

Preparation for a Real Property Audit

L3-23

When an SOP is established for the accountability of real property, the SOP communicates who does what, when, and why. For example, if an SOP is established at the installation level, it would include steps individuals use to:

- account for and be responsible for the custody, safekeeping, and effective use of land, buildings, structures, and facilities
- document and maintain real property accountability records
- ensure the accuracy, completeness, and timeliness of the real property information
- report on all real property information
- establish custody and accountability for excess and surplus property
- account for all property transferred in or out of the installation
- ensure physical accountable inventories of all real property are conducted at least once every five years and that information is on file
- report the results of status of physical inventories as of September 30.

This slide is an example of steps that are included in an SOP.

Let's talk about the two memorandums that deal with real property.



Rules for Real Property (cont.)



Applying Real Property Business Rules

- **Financial Improvement Initiative Assertion Package Criteria and Organization**
- **Financial Improvement Initiative Business Rules**

Version 1.0

Preparation for a Real Property Audit

L3-24

These are two memorandums that were issued by the Office of the Under Secretary of Defense (OUSD) to follow to get an unqualified audit opinion.

Let's talk about the Financial Improvement Initiative Assertion Package Criteria and Organization.



Rules for Real Property (cont.)



**Office of the Under Secretary of Defense (OUSD),
Memorandum:**

**“Financial Improvement Initiative Assertion Package
Criteria and Organization,” dated November 15, 2004**

Version 1.0

Preparation for a Real Property Audit

L3-25

The Financial Improvement Initiative Business Rules established business rules for the five phases of the financial improvement initiative. These business rules and phases apply directly to those entities required by the DoD to prepare stand-alone financial statements. However, all other DoD agencies, entities, and funds, even if not required to prepare stand-alone financial statements, should prepare improvement plans to ensure their trial balances are auditable.

The package is submitted to the DoD OIG with a copy to the Review and Prioritization Subcommittee (RPS). The DoD OIG asks the RPS to review each package and make a recommendation to the Executive Steering Committee (ESC). The ESC makes a recommendation to the DoD OIG about whether to proceed with an assessment and audit of your financial statement line or statement.

Included in this memorandum is an 18-step checklist entitled “Assertion Package Organization and Review Criteria.” The checklist is used to organize your assertion package.

Let’s discuss the Financial Improvement Initiative Business Rules.



Rules for Real Property (cont.)



**Office of the Under Secretary of Defense (Comptroller)
(OUSD(C)) Memorandum:**

**“Financial Improvement Initiative Business Rules,”
dated June 23, 2004**

Version 1.0

Preparation for a Real Property Audit

L3-26

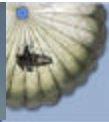
This memorandum established business rules DoD entities need to follow to get an unqualified audit opinion. These business rules provide the framework for the DoD to move its financial statements from a position of unreliability to that of reliability and, ultimately, to an unqualified audit opinion.

Next, we will discuss the five phases of the business rules:

- Discovery and Correction
- Validation
- Assertion
- Assessment
- Audit.

It is important for you to understand these five phases of the business rules and closely monitor your improvement plans which will lead to an unqualified audit opinion.

Let's talk about the five major phases of the Financial Improvement Initiative Business Rules.



Rules for Real Property (cont.)



Major Phases

Discovery and Correction	Validation	Assertion	Assessment	Audit
WHY <ul style="list-style-type: none"> Discover problems Evaluate solutions Plan solutions Correct processes Complete policy Complement BMMP HOW <ul style="list-style-type: none"> Develop improvement plans Establish audit committees Develop systems strategy Prepare business cases for systems changes Prepare and review full set of financial statements each quarter 	WHY <ul style="list-style-type: none"> Enhance credibility of assertions HOW <ul style="list-style-type: none"> At beginning, coordinate and obtain comment from DoDIG and notify RPS Management documents processes, identifies controls & systems, and ensures auditable universe of transactions & supporting documentation is available Management requests validation of financial information Performed by internal review, component's audit agencies, or external audit firm 	WHY <ul style="list-style-type: none"> Communicate to DoDIG and auditors reliability of financial information HOW <ul style="list-style-type: none"> Assertion letter to DoDIG that: <ol style="list-style-type: none"> Responds to DoDIG's instructions Includes checklist Includes results of validation and reports Engagement letter and management representative letter, if used Memo to DoDIG, copy to OUSD (C) RPS ESC approval for assessment/audit 	WHY <ul style="list-style-type: none"> Allows remediation Attests to management assertion Plan audit Reduce risk of unknowns (auditor) Introduction to organization (auditors) HOW <ul style="list-style-type: none"> DoDIG oversight of IPAs DoDIG in-house 	WHY <ul style="list-style-type: none"> Implement CFO Act Implement 1008 Presidents' Management Agenda HOW <ul style="list-style-type: none"> Pass assessment DoDIG oversight of IPAs

Version 1.0

Preparation for a Real Property Audit

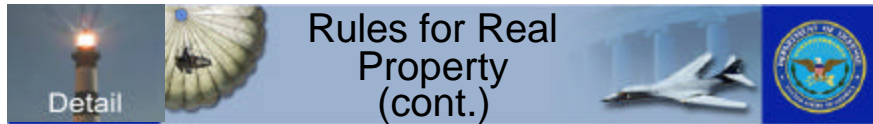
L3-27

DoD is accomplishing the task of improved financial management through several initiatives, including the Financial Improvement Initiative Business Rules. The primary indicator of success is an unqualified audit opinion on the Department's financial statements.

This improvement initiative encompasses policies, processes, controls, defense business systems, personnel, organizations, performance metrics, and auditor assessments and audits that are directly or indirectly related to the Department's financial management.

The plan has a five phases designed to prepare entities to pass a financial audit and to improve their ability to control and report on their financial activities. Senior management with real property office support work together ensuring availability of supporting documentation.

Let's discuss ways the Department applies these rules.



Discovery and Correction Phase

- **Develop improvement plans**
- **Establish audit committees**
- **Develop strategic plans**
- **Prepare business cases for systems changes**
- **Prepare and review financial statements quarterly**



Version 1.0

Preparation for a Real Property Audit

L3-28

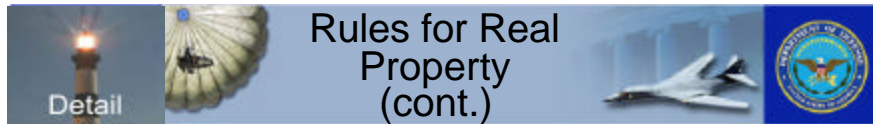
During the Discovery and Correction Phase, solutions are planned to correct deficiencies prior to the audit of your financial statements. Improvement plans are implemented to establish accountability of real property. For example, metrics and measurements are used for establishing 100% accountability of real property.

Audit committees are established to:

- hold management accountable
- provide a new perspective for long-standing issues as well as best practices
- enhance communication on financial matters to senior management
- discuss controversial matters with the DoD OIG
- resolve differences regarding audit findings and recommendations
- ensure management is addressing financial management concerns.

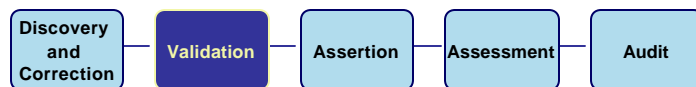
Management ensures that financial and property management systems are compliant to ensure that information flowing to the financial statements is correct. DoD Components must comply with OMB's requirement to produce quarterly unaudited financial statements.

Let's discuss the Validation Phase.



Validation Phase

- **Coordinate with the DoD OIG**
- **Ensure auditable universe of transactions and supporting documentation is available**
- **Validate financial information by auditors**



Version 1.0

Preparation for a Real Property Audit

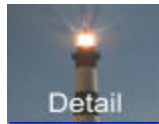
L3-29

The Department notifies the DoD OIG of its intent to validate a line or a statement and any corrective actions required to correct deficiencies during this phase.

When preparing an auditable universe, accounting transactions and supporting documentation must be available for the real property. This includes data from non-financial systems, subsidiary ledgers and journal vouchers, correspondence or data calls, contracts, or invoices to support data input. Financial information is verified for the selected statement or line item to the original transactions. For example, a line is selected from a Balance Sheet account such as General PP&E. The Balance Sheet total is compared to Note 10. A major asset class is selected from Note 10 and then traced to the original supporting documentation.

When performing corrective action validation and while preparing the assertion package, the checklist contained in the Financial Improvement Initiative Business Rules is used. The checklist includes information on financial statement balances, supporting documentation, validation procedures, organizational charts, compliance with FISCAM and SAS 70/88, and systems information.

Let's look at the Assertion Phase.



Rules for Real Property (cont.)



Assertion Phase

Assertion memorandum includes:

- **Assertion letter**
- **Summary of validation work and deficiencies resolution**
- **Reports from validation**
- **Completed checklist**



Version 1.0

Preparation for a Real Property Audit

L3-30

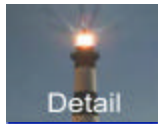
During the Assertion Phase, the entity prepares a Management Assertion Memorandum. It informs the DoD OIG that the entity has completed corrective actions of the material deficiencies to the PP&E items on the Balance Sheet and is ready for audit.

The entity notifies the DoD OIG that its PP&E deficiencies were corrected during the Validation Phase and that a financial statement or line item is ready for audit. When the package is furnished to the DoD OIG, a copy is also furnished to the OUSD(C) Point of Contact (POC) who will forward it to the Review and Prioritization Subcommittee (RPS). The assertion package contains:

- management's assertion letter asserting audit readiness of the line or statement that has been validated
- a summary of the validation work performed and how the deficiencies were resolved by management
- the reports resulting from the validation and the checklist completed during the Validation Phase
- the completed checklist.

The DoD OIG reviews the assertion package and determines whether it will conduct an assessment of the entity's PP&E line or statement, or bypass the Assessment Phase and proceed to the Audit Phase. It is the judgment of the DoD OIG whether to assess or audit. The entity will be notified if it is approved for assessment or audit.

Let's discuss the processing of an assertion package during the Assessment Phase.



Rules for Real Property (cont.)



Assessment Phase

- DoD OIG oversight of independent public accountants (IPAs)
- DoD OIG in-house



Version 1.0

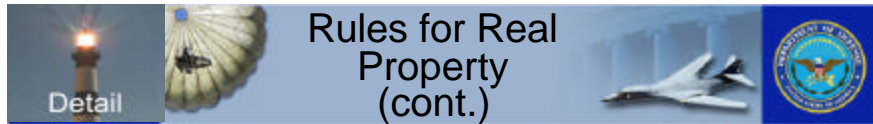
Preparation for a Real Property Audit

L3-31

This phase is performed by the DoD OIG or the Independent Public Accountants (IPAs). In most cases, an assessment is conducted if financial statements have never been audited.

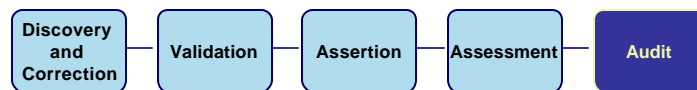
The scope of the assessment is determined in accordance with the GAO/PCIE FAM and consists of accomplishing audit steps outlined in the Planning Phase and Internal Control Phase of the FAM.

Let's discuss what is done in the Audit Phase.



Audit Phase

- **Pass assessment**
- **DoD OIG oversight of IPAs**



Version 1.0

Preparation for a Real Property Audit

L3-32

A determination is made during the Assessment Phase whether an entity can achieve an unqualified opinion on their financial statements.

When your financial statements or line item is asserted and ready for audit and has passed assessment, or assessment has been waived, the DoD OIG determines the appropriate scope and nature for financial audit.

During this Audit Phase, your accounting records are audited to determine if the balances and related notes presented on your financial statements fairly present the operations of your entity.

Let's discuss the roles and responsibilities.



Roles and Responsibilities



Responsible Parties during the Assertion Process

- **Auditor**
- **Auditee**
- **Managers**
- **Defense Finance and Accounting Service**
- **DoD reporting entities**
- **Various guidance provided at all levels**

Version 1.0

Preparation for a Real Property Audit

L3-33

During the assertion process, the auditor, auditee, managers, DFAS, and DoD reporting entities have different roles and responsibilities.

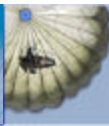
In the assertion process for real property, we must ensure there is adequate evidential documentation, including systems files and hard copy documentation available to support lines on the financial statements. The different reporting entities must verify procedures and internal control.

The purpose of the Assertion Phase is to notify the DoD OIG that validation of corrected deficiencies has been completed and the financial statements or line item is ready for audit.

Communication is important during the assertion process throughout the organization and with the auditors.

Also, during this phase, various guidance from the OMB must be applied.

Let's discuss the role and responsibility of the auditors.



Roles and Responsibilities (cont.)



DoD OIG is the independent auditor for the DoD and is responsible for:

- **Performing audits of departments, programs, and operations**
- **Conducting and supervising financial audits within the Department**
- **Identifying material weaknesses**

Version 1.0

Preparation for a Real Property Audit

L3-34

The DoD OIG's mission is to be an independent and objective entity within the DoD. It is responsible for conducting and supervising audits relating to the programs and operations of the Department.

The DoD OIG is responsible for the audits of the Department's financial statements. As the Department's financial operations are updated and its financial statements become ready for audit, the DoD OIG performs the audit or contracts with IPAs to perform the audit under the guidance of the DoD OIG Business Rules.

The DoD OIG is a key in the Financial Improvement Initiative Business Rules and provides financial and operational expertise. For example, the DoD OIG identified material weaknesses reported in the Department's FY 2004 Performance and Accountability Report.

The DoD OIG assists the Department in determining areas requiring updating. In addition, the DoD OIG participates, as a non-voting member, on the audit committees of the Components preparing financial statements.

The DoD OIG holds advisory membership on the Executive Steering Committee, the Review and Prioritization Subcommittee, and the Funding Subcommittee, which make up the governing structure for the Financial Improvement Initiative.

Let's talk some more about the duties of the auditors.



Roles and Responsibilities (cont.)



The auditors' responsibilities include:

- **Understanding the entity's internal control**
- **Providing the PBC List**
- **Examining evidential matter**
- **Auditing or assessing**
- **Communicating issues and progress**
- **Expressing an opinion**

Version 1.0

Preparation for a Real Property Audit

L3-35

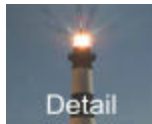
After an entity is selected for audit, the auditors acquire an understanding of the organization's internal control by reviewing the reporting entity's assertion package.

Auditors provide a list of items required prior to the audit. This list is called the Prepared by Client (PBC) list. The list is examined to ensure that supporting evidence supports the amounts and disclosures on the financial statements.

If the results of the assessment indicate that an area is not ready for audit, the auditors identify those deficiencies and provide recommendations to the Department. When results indicate the entity is ready for audit, the auditors establish audit procedures.

The DoD OIG or the IPA performs the audit in a professional and effective manner. During the audit process, the auditors communicate progress, address issues, and finally express an audit opinion.

We discussed the role of the auditor, now let's look at the auditee.



Roles and Responsibilities (cont.)



The auditee is responsible for:

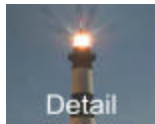
- **Providing accounting information and evidential matter required by the auditors**
- **Having knowledgeable managers, accountants, technicians, and systems personnel**
- **Explaining any departures from normal accounting practices**

A well-prepared audited organization is represented by an audit committee. The committee members are responsible for the overall presentation of auditing information to the auditors. They are also responsible for working as the liaison between the organization and the auditors. The team members must respond to questions regarding the financial data and the entity's operations.

The committee is composed of managers, accountants, technicians, and systems personnel. These members of the audited entity assigned to the audit of the financial statements must collectively have sufficient knowledge of the organization, functions, systems, and mission.

The team members must have knowledge of the normal balances, transactions, and procedures and be able to explain any abnormalities. When there are departures from normal procedures, they must be supported by proper justification and approval.

Let's discuss more responsibilities of the auditee.



Roles and Responsibilities (cont.)



Liaison duties between management and the auditors include:

- **Assigning a Point of Contact (POC)**
- **Providing evidential matter**
- **Explaining internal control procedures**
- **Providing information on the PBC List**

Version 1.0

Preparation for a Real Property Audit

L3-37

The POC is assigned by the audited entity to work with the auditors. Responsibilities include providing audit record keeping, information gathering, explaining internal control activities and procedures.

Audit recordkeeping includes maintaining a record of requests for information from the auditor. Most of the request come from the information provided on the PBC list. The PBC list is a record of requested information, documentation, date needed, date supplied, and who the entity's POC is for any detailed information.

When gathering the required information, data query and document searches are required. Procedures for gathering information are established prior to the audit to facilitate data access.

It is important that the requested data complete, correct, and reliable. The running of test data ensures that procedural problems are discovered prior to the audit. Sample information should be traceable for the financial statements to the transaction level.

Let's discuss the manager's role in the audit process.



Roles and Responsibilities (cont.)



The managers' responsibilities include:

- **Complying with requirements of OMB Circular A-123**
- **Taking systemic and proactive measures**
- **Reporting annually on internal control**
- **Following-up on audit recommendations**
- **Providing information on financial statements**
- **Assuring reliability of information on financial statements**
- **Testing, reconciling, and analyzing financial data**

Version 1.0

Preparation for a Real Property Audit

L3-38

OMB Circular A-123 defines the manager's responsibility for the quality and timeliness of program performance, increasing productivity, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable laws.

The managers take systemic and proactive measures to develop and implement management controls. They also identify any improvements, take corrective action and report annual on these management controls.

The audits are assessments of how an entity controls and accounts for their resources. Managers are required to follow-up on audit recommendations and take appropriate corrective action.

The agency's reporting package includes the Management Discussion and Analysis (MDA), the financial statements, and accompanying footnotes.

During the audit, the auditor tests the reliability of the information provided by management. The information includes the financial statements, reports on management controls, and other assurances or representations by management.

Procedures used by management in the performance of its duties include testing, reconciling, and analyzing financial data to validate the financial information prepared for audit.

Let's look at an entity that provides financial support to the DoD.



Roles and Responsibilities (cont.)



DFAS provides finance and accounting services to the:

- **Army**
- **Navy**
- **Air Force**
- **Marine Corps**
- **Defense Agencies**



Version 1.0

Preparation for a Real Property Audit

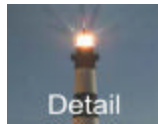
L3-39

The mission of DFAS is to provide responsive, professional finance and accounting services for the people who defend America. Goals of DFAS are to:

- satisfy customer requirements and resolve problems
- use performance metrics to drive best business practices and achieve quality results
- optimize the mix of work force
- establish consultative relationship with leaders
- deliver business intelligence to enable better decisions
- ensure everyone is working toward the same vision and make it a reality
- embrace continuous learning to ensure critical, high quality skill sets
- develop the next generation of DFAS.

DFAS continuously reviews finance and accounting systems and procedures, and identifies improvements that can be made to processes and systems. Its initiatives are focused on fixing business process that are with its control such as Fund Balance with Treasury (FBWT), Real Property, Accounts Receivable, Accounts Payable, and financial systems. DFAS holds DoD-wide conferences on systems audits with customers, the DoD audit community, and the GAO.

Let's look at the responsibilities of the reporting entities.



Roles and Responsibilities (cont.)



DoD reporting entities' responsibilities include:

- **Preparing agency annual financial statements in accordance with OMB guidance**
- **Utilizing the Financial Improvement Initiative Business Rules**

Version 1.0

Preparation for a Real Property Audit

L3-40

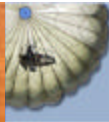
Reporting entities include the Military Departments and the Defense Agencies, and are required to prepare annual auditable financial statements.

OMB guidance for the preparation of financial statements includes:

- OMB Bulletin No. 01-02, Audit Requirements for Federal Financial Statements, which establishes minimum requirements for audits of federal financial statements
- OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements, which defines the form and content for federal agency financial statements that are required to be submitted to OMB and Congress.

DoD entities must follow the Financial Improvement Initiative Business Rules in order to achieve an unqualified audit opinion.

Let's discuss the Discovery and Correction Phase.



Discovery and Correction



Discovery and Correction Phase:

Management identifies deficiencies and implements corrective actions.

Why	How
Implement 1008, discover problems, evaluate solutions, correct processes, complete policy, complement BMMP	Develop improvement plans, establish audit committees, develop systems strategy, prepare business cases for systems changes, prepare and review financial statements each quarter

Version 1.0

Preparation for a Real Property Audit

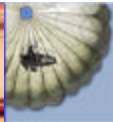
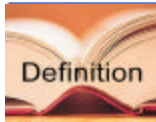
L3-41

The Discovery and Correction Phase is intended to correct deficiencies and plan solutions to produce accurate data.

Managers must identify problem areas or deficiencies, then develop solutions to those problems. Problems may be identified from prior assessments or audits, analysis, tests of controls, or internal reviews of operations and procedures. They may include DoD issues and systems, issues affecting your subordinate organizations (your suballotees), or issues that are internal to your operation. Once problems are identified, you develop plans for corrective action.

These plans must include responsibilities, milestones, and required resources. They should take into account the plans of your subordinate organizations and may depend on the plans of higher organizations. You must monitor progress both within and outside of your organization to ensure that milestones are reached. Resources outside of your organization may be available to you, and solutions found by other organizations may be applicable to problems within your operation. Plans for corrective action may already be initiated on deficiencies found on previous audits and assessments, and new problems may be identified during their correction.

Let's break this phase down into it's two components, discovery and correction.



Discovery and Correction (cont.)



Discovery: identify obstacles and prepare corrective action plans in pursuit of an unqualified audit opinion.

- **Prepare the financial improvement plans**
- **Identify all known deficiencies**
- **Consider whether systemic problems exist**

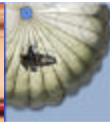
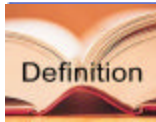


During discovery, you identify obstacles that could prevent the entity from obtaining an unqualified audit opinion and to prepare improvement plans with solutions that have measurable outcomes for overcoming those obstacles.

Managers and staff should be encouraged to identify and report deficiencies, as this reflects positively on the agency's commitment to recognizing and addressing problems. Failing to report a known deficiency would reflect adversely on the agency. Agencies should carefully consider whether systemic problems exist that adversely affect internal control across Departmental or program lines.

In the Discovery and Correction Phase, entities prepare the financial improvement plans for achieving an unqualified audit opinion. Entities also identify, by financial statements line item, all known deficiencies relating to the line item, including accounts requiring correction or processes requiring improvement.

Let's learn more about what is involved in the Discovery and Correction Phase.



Discovery and Correction (cont.)



Discovery (cont.):

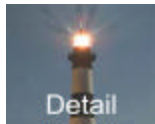
- Identify material weaknesses
- Prepare corrective action plans
- Incorporate effective oversight



Managers should identify deficiencies that have a material impact on the financial statements and prioritize corrective actions. Management personnel then prepare comprehensive corrective action plans to resolve the deficiencies. Plans must identify how staff (human capital), processes, or business systems would be changed to implement corrective actions. The plans must then incorporate effective oversight mechanisms to ensure that they are carried out and that the corrections are attainable. In addition, managers must base milestones on actual estimates of the effort required and identify critical task dependencies.

If current systems must be modified and the modifications are part of the corrective actions, management personnel prepare a business case to support the modification, submit the case to the Business Management Modernization Program (BMMP) office, and advise the assigned OUSD(C) POC.

Let's explore some areas where problems are found.



Discovery and Correction (cont.)



Sources of weaknesses:

- **Prior audit/inspection reports**
- **Lessons learned**
- **Reviews of policies, procedures, and processes**
- **Actual analysis**



Version 1.0

Preparation for a Real Property Audit

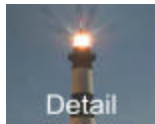
L3-44

Problems are found on audit and inspection reports, from lessons learned in similar organizations, or from reviews of policies, procedures, and processes. They are also identified through analysis of financial information, documentation, and financial systems.

Similar entities experienced problems in areas not found on previous inspections or audits of your entity. Reviewing the findings of other entities may provide areas needing improvement in your entity.

The DoD Component reviews policies, procedures, and processes to ensure that they are compliant with legal and regulatory guidance, and that they ensure adequate controls over entity resources. New procedures may be required in the absence of pre-existing procedural guidance, especially in areas of high personnel turnover, complicated processes, or high-value asset use.

Let's continue with these sources.



Discovery and Correction (cont.)



Sources of weaknesses (cont.):

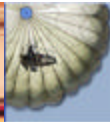
- **Analysis of transactions and balances**
- **Trace transactions from origin to the financial statements**
- **Use available resources to perform systems analysis**

Analysis of financial information, source documentation, and accounting systems is used to identify unusual balances or entries, audit trails and areas of inadequate documentation, and system controls. Unusual balances or entries result from a failure to comply with policy, procedure, or control, or from fraud.

Documentation must be available so it can be traced from its origin to the financial statements. An analysis of the transaction required for transaction types assists in making this identification. Reversing the process traces the documentation from the financial statements to its origins. Auditors must be able to trace your transactions all the way to the originating source documents. They must also be able to verify from those documents that amounts recorded on the financial statements are based on factual information.

Analysis of financial systems may be accomplished using resources from outside of your entity. For example, the Defense Information Systems Agency (DISA) and DFAS. Systems are analyzed to ensure that they are compatible with the future plans of the Department, and that they apply adequate controls for transaction authorization and separation of duties. They are also analyzed for their ability to provide meaningful financial information in a timely manner.

This leads to the second half of the Discovery and Correction Phase, correction.



Discovery and Correction (cont.)



Correction: requires DoD entities to implement solutions within the milestone dates prescribed, resulting in a resolution of the identified deficiency.

- **Identify new deficiencies**
- **Modify plans to include any additions**
- **Requests for extension of dates should include a plan for getting back on track to meet the next original milestone date**



Version 1.0

Preparation for a Real Property Audit

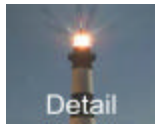
L3-46

Correction requires DoD entities to implement solutions within the milestone dates prescribed, resulting in a resolution of the identified deficiency.

Correction is a multi-faceted and incremental process. In other words, all corrective action steps are not expected to be completed on the same date. Management personnel and audit committees at each activity closely monitor progress to ensure that actions taken achieve the intended result in the time allotted.

While corrections are ongoing, new deficiencies may be identified. As this occurs, activities coordinate with their OUSD(C) POC to modify plans to include any such additions. Requests for extension of dates must include actions taken to date, reason for date slippage, new proposed completion date, and a plan for getting back on track to meet the next original date.

Let's consider these requirements.



Discovery and Correction (cont.)



Correction Requirements

- **Timely and incremental**
- **Resolves discrepancy**
- **Monitor progress and coordinate**
- **Extensions**

Version 1.0

Preparation for a Real Property Audit

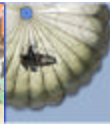
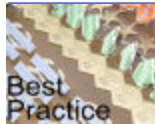
L3-47

Correction plans must contain milestones and goals that are clearly measurable. Plans are incremental to allow for actions that may involve more than one entity. Management must assign tasks to responsible individuals in accordance with the corrective action plans and monitor progress. Individuals are held accountable for the accomplishment of their assigned tasks using a Balanced Scorecard approach.

As with many projects, problems may be encountered that require additional resources or time. Management may reassign resources or request assistance from outside sources. Identified problems may require action from other entities prior to correction of the original discrepancy. In such cases, managers may reorganize actions that are not dependent upon the delayed processes to allow for the continuation of corrections.

When other entities depend on the resolution of your deficiency, it is important to coordinate with the dependent entity. Together, you should work to identify resource requirements, coordinate schedules, and modify interim milestones. As mentioned earlier, you must have a plan for meeting the next original milestone.

Let's examine some best practices.



Discovery and Correction (cont.)



Best Practices

- **Hold regular progress reviews**
- **Know your deficiencies**
- **Document responsibilities**

Version 1.0

Preparation for a Real Property Audit

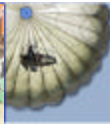
L3-48

A best practice in a similar organization is to schedule progress reviews on a regular basis. As part of the monitoring process, reviews allow managers to identify resource requirements not anticipated in the corrective action plans. Reviews have clear agendas and require responses from participants on the status of their progress.

The best organizations know their deficiencies and assess their operations on a regular basis. A recent best practice within the Department is to brief midyear and end-of-year financial statements to the DoD Comptroller. According to the GAO and the DoD OIG, the practice of preparing and explaining interim financial statements has improved the reliability of reported information through more timely discovery and correction of numerous recording and reporting errors.

Responsibilities should be documented to ensure that you have clearly communicated who must perform the action, what must be done, when it must be completed, and the expected result of that action.

Let's discuss a couple more best practices.



Discovery and Correction (cont.)



Best Practices (cont.)

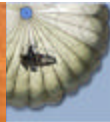
- **Partner with DFAS**
- **Use available assistance**
- **Other audits or auditors' reports**

Successful organizations do not attempt to solve problems outside of their areas of expertise. DFAS is a valuable source of assistance. Its employees are familiar with audit requirements and have passed more than one financial statements audit. They are knowledgeable of financial reporting requirements, documentation requirements, financial systems and their capabilities, and financial management trends.

They may provide assistance in analysis of financial transactions and balances and may be able to explain unusual transactions that affect your financial statements.

Audit agencies may provide assistance with analysis and historical audit records.

Let's move on to the Validation Phase.



Validation



Validation Phase:

Management validates financial information after corrective actions are completed.

Why	How
Implement 1008, enhance credibility of assertions, validate corrections.	First, management coordinates with DoD OIG and notifies RPS. Second, management validates that processes are documented, controls and systems are identified, and supporting documentation is available.

Version 1.0

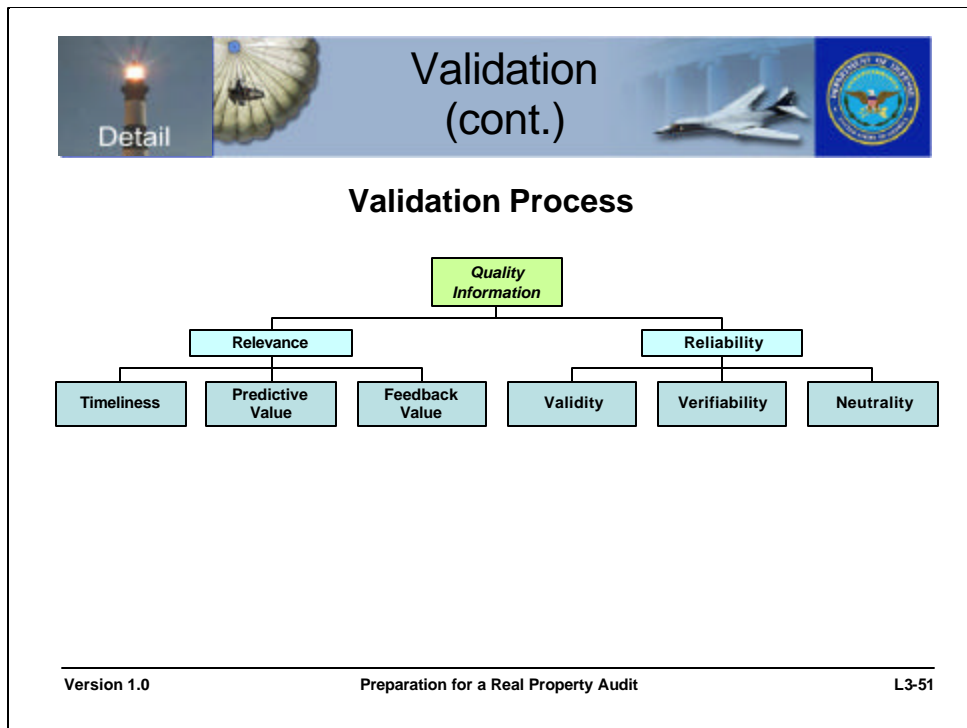
Preparation for a Real Property Audit

L3-50

The Validation Phase validates the effectiveness of the corrective actions. Validation determines whether sufficient controls and transaction information are available to support management's assertion that the line or financial statements are ready for audit, and ensures that supporting documentation is available during the audit.

The validation is a limited scope evaluation or review to determine whether previously identified deficiencies in an entity's financial statements or line items have been satisfactorily corrected. This review is the responsibility of management and performed by management, internal auditors, or an IPA under the supervision of the DoD OIG. The scope of specific procedures required for each validation are also the responsibility of management and are determined in the context of the materiality of each issue or action taken.

Let's continue with more of the Validation Phase.



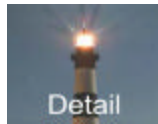
At the beginning of the Validation Phase, the entity notifies the DoD OIG by memorandum, with a copy furnished to the entity's OUSD(C) POC, of the entity's intent to validate a line item or statement and the corrective actions taken to resolve deficiencies. It is important to tell the DoD OIG what you plan to do. The DoD OIG must be aware of the validation technique being performed by the entity prior to the initiation of the validation process to facilitate the assessment process after the entity submits its assertion package. Although the DoD OIG has no specific role in the validation, the DoD OIG may, in an advisory capacity, comment on any obvious flaws or items of concern related to the validation methodology.

The OUSD(C) POC then notifies the Review and Prioritization Subcommittee (RPS). The RPS notifies the Executive Steering Committee (ESC), and, if any concerns exist, the ESC provides a memorandum to the entity conveying its concerns.

The notification includes the intended method for validating that the corrective action corrected the known deficiency, and that the line or statement is ready for audit. Once required notification is sent, and validation methods are planned, the validation process begins.

The validation process is primarily for management to determine whether a particular statement or line is ready for an assessment or audit by the DoD OIG. To be audit-ready, information provided in the statement or line must be both relevant and reliable. Relevance is related to the usefulness of the information, such as its timeliness, predictive value, or feedback value. Reliability relates to the accuracy of the information. To be reliable, the information must be valid, verifiable, and unbiased or neutral. If management determines that the statement or line is ready, the work accomplished during validation may be used by the DoD OIG.

Let's discuss the actions required in this phase.



Validation (cont.)



Financial Improvement Initiative Checklist (Page 1 of 2)

CONFIDENTIAL

When performing corrective action validations and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.

This checklist is designed to help components prepare the assertion by providing the information that is typically required for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditor in the form of a "Prepared By Client (PBC) List."

The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in verifying that these steps have been completed:

- ☐ 1 Identify and document the processes, procedures, and control points for deriving the information being asserted. Include the systems that are used and the flow of data from feed into the information being asserted. This can be done in a simple memorandum or flow-chart format. Having the information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditor will need to document the information on you will already have the information required. Be sure to identify all systems that have data that relates to the information being asserted as ready for audit.
- ☐ 2 Review General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balances being asserted. Review the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.
- ☐ 3 Considerable evidence must be provided to support the transactions in step 2 or map the evidence rather to auditable items and equivalent internal.
- ☐ 4 Prepare a summary of the validation work performed by management, Service Auditor, Internal Auditor, or independent public accounting firm to support audit readiness, if applicable.
- ☐ 5 Complete all the corrective actions in your Mid-Range Financial Improvement Plan for the internal deficiencies related to the deficiencies being asserted.
- ☐ 6 Using the information from number 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as an attachment to the letter. Be very specific.
- ☐ 7 Complete organization charts indicating key personnel and their responsibilities and phone lists.
- ☐ 8 For all the systems identified in step 1 above, has there been a Financial Information Security Audit (FISMA) or Statement of Auditing Standards (SOA) TOB audit completed on the system?

☐ Yes. If yes, provide the date and scope of audit.

☐ No.

Version 1.0

Preparation for a Real Property Audit

L3-52

In the Validation Phase, the entity performs a validation of the resolution of the identified deficiencies. These validations are performed at the request and under the oversight of management. Audit committees within the entity should be actively engaged in overseeing the progress of the validation process.

At this time, management completes a checklist that is required for the assertion package. It consists of two pages with 18 items. The example above shows the first page. It includes documenting the processes, providing General Ledger transactions from feeder systems, and ensuring that supporting documentation is available, to name a few. This checklist and accompanying assertion information is used later during the Assessment and Audit Phases, and may be viewed in Appendix C, Financial Improvement Initiative Checklist.

Let's examine the first step to demonstrate the use of this validation tool.



Validation (cont.)



Checklist Step 1

- **Identify and document the procedures, processes, and control points for deriving the balances**
- **Include the systems that are used and the flow of data from field level to departmental level**
- **Identify all systems that have detail that make up the balances**
- **Include process cycle memos and flow charts**

Version 1.0

Preparation for a Real Property Audit

L3-53

In the first step, the user needs to identify and document the procedures, processes, and control points for deriving the balance or balances being asserted. The user needs to include the systems that are used and the flow of data from field level to departmental level.

Cycle memoranda or flow charts provide invaluable assistance in documenting the information already prepared. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. The auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that make up the balances being asserted as ready for audit.

Earlier, we covered the need to identify and document the procedures, processes, and controls within your entity. This process began in the Discovery and Correction Phase while you were working on the identification of problems and planning corrective actions. It continues and is completed in the Validation Phase.

The instructions also include the criteria used to evaluate whether or not the required action was satisfactorily completed.

Let's look at additional steps on the checklist.



Validation (cont.)



Financial Improvement Initiative Checklist (Page 2 of 2)

- ☐ 9 For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISICAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10.
- If a FISICAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the following information will have to be gathered prior to the audit for each system.
- ☐ 10 Prepare a description of the major hardware and software of the system and interfaces with other systems.
- ☐ 11 Describe what type of data the system produces for the financial statements, e.g. accounting transactions.
- ☐ 12 Prepare a description of telecommunications devices and networks used with the system.
- ☐ 13 Obtain a copy of the most recent certifications and accreditations of the system.
- ☐ 14 Identify the system location(s) and end user locations.
- ☐ 15 Identify the location(s) of system documentation.
- ☐ 16 Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.
- ☐ 17 Obtain a list of all system users - this should be a print out that shows the user and level of access.
- ☐ 18 Inquire if there are any ongoing or planned system reviews - if there are, determine when the reviews will be complete.

Version 1.0

Preparation for a Real Property Audit

L3-54

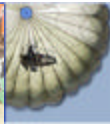
The evaluation criteria for processing cycle memos and flow charts state that a flowchart is required for each major process and a cycle/process memorandum should be provided to:

- accurately describe the regulations followed for the process
- document procedures utilized
- document key control techniques
- identify systems used at the departmental level
- include the management control objectives and risk assessments.

You should review the flowcharts, cycle/process memorandum, and supporting documents for reasonableness and completeness for each process listed. The checklist will assist in providing the information details necessary to make the assertion package complete. Page 2 of the checklist above shows further steps to guide entities for preparing a description of the major hardware and software of your systems, describing the type of data these systems produce, preparing a description of telecommunications devices and networks used with the systems, obtaining copies of the most recent system certifications and accreditations, and identifying system locations, documentation, and users.

The GAO/PCIE FAM, Section 390.04, Cycle Memorandum and Flowchart, describes a cycle memorandum. Use of this manual was discussed in Lesson 2, Auditable Data and Audit Methodology. More information on the requirements for cycle memoranda is available in the How to Manage Audit Evidential Matter course.

Let's consider a few best practices.



Validation (cont.)



Best Practices during the Validation Phase

- **Think like an auditor**
- **Have a good method for organizing documentation, and use document review products such as EDA or EDM**
- **Establish audit trails and keep a copy of the database, current output, and reports**

Version 1.0

Preparation for a Real Property Audit

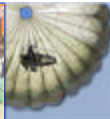
L3-55

Some best practices may assist you in the validation process. To begin with, think like an auditor. This includes the use of audit checklists, references, and tools that an auditor uses to assess the information that you supply. Procedures used by auditors rarely call for in-depth analysis or complicated calculations. Audit opinions are based on solid research of your policies, practices, and procedures, and the resultant financial information reported.

A good method for organizing source documentation is needed. Products such as Electronic Document Access (EDA) or Electronic Data Management (EDM) can help in reviewing documents.

DoD entities that have obtained unqualified audit opinions, establish clear audit trails. Once audit trails are established, records of tests of documentation procedures can be maintained to substantiate audit readiness. It is a good idea to keep a copy of the database, current output, and reports used in your analysis of financial information. Conclusions drawn using a particular set of data may not be valid when the data changes during the next accounting cycle, though the procedures for gathering that data should not change from one period to the next.

Let's discuss more best practices.



Validation (cont.)



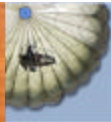
Best Practices during the Validation Phase (cont.)

- **Ensure that top management is involved and establish an audit committee or audit interest group**
- **Establish an audit committee**
- **Have good report writers**

Senior management involvement is critical, and having an audit committee or audit interest group ensures that those personnel who must answer audit inquiries are involved in the process. With their involvement, senior management emphasizes the importance of the effort.

Remember that top management may not have time to review detailed technical data. You must have good report writers to summarize the data presented by technicians, accountants, and analysts.

Now let's look at the Assertion Phase.



Assertion



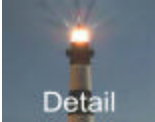
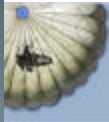
Assertion Phase:

Management affirms to the DoD OIG the reliability of the financial information.



Why	How
Communicate to DoDIG and auditors the reliability of financial information.	Assertion letter to DoDIG, checklist, and results of validation and reports; engagement letter and management representative letter, if used; memo to DoDIG, copy to OUSD(C) RPS; ESC approval required for assessment or audit

The Assertion Phase notifies the DoD OIG that validation of corrected deficiencies has been completed and that a financial statement or line item is ready for audit. During the Assertion Phase, management prepares an assertion memorandum stating audit readiness and a package of accompanying documentation to support the position of audit readiness.

Let's learn more about this Assertion Phase.


Assertion (cont.)

Assertion Package

DFAS-Indianapolis		Section III Assertion Packet Checklist
Prepared by Brook Avey	Client Army General Funds	Date November 30, 2004
<input checked="" type="checkbox"/> Identify and document the procedures, processes, and control point for deriving the balances being asserted. Include the systems that are used and the flow of data		

DFAS-INDIANAPOLIS	SECTION VI VALIDATION CERTIFICATION
Client Army General Funds	Date January 3, 2005



DEFENSE FINANCE AND ACCOUNTING SERVICE
8800 EAST 56TH STREET
INDIANAPOLIS, INDIANA 46249

Department of the
Army meets all of
the requirements of
the DoD Financial
Management Improvement
Program (DFMIP) 04. All
information is available to view
on the Internet.

DFAS-IN/ADRA JAN 06 2005

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Management Assertion for the Army General Fund Balance with Treasury

We are asserting that Fund Balance with Treasury for Army General Funds is audited and we have completed corrective actions on material deficiencies for the Fund Balance with Treasury line item on the balance sheet. Fund Balance with Treasury is fairly presented in

Version 1.0
Preparation for a Real Property Audit
L3-58

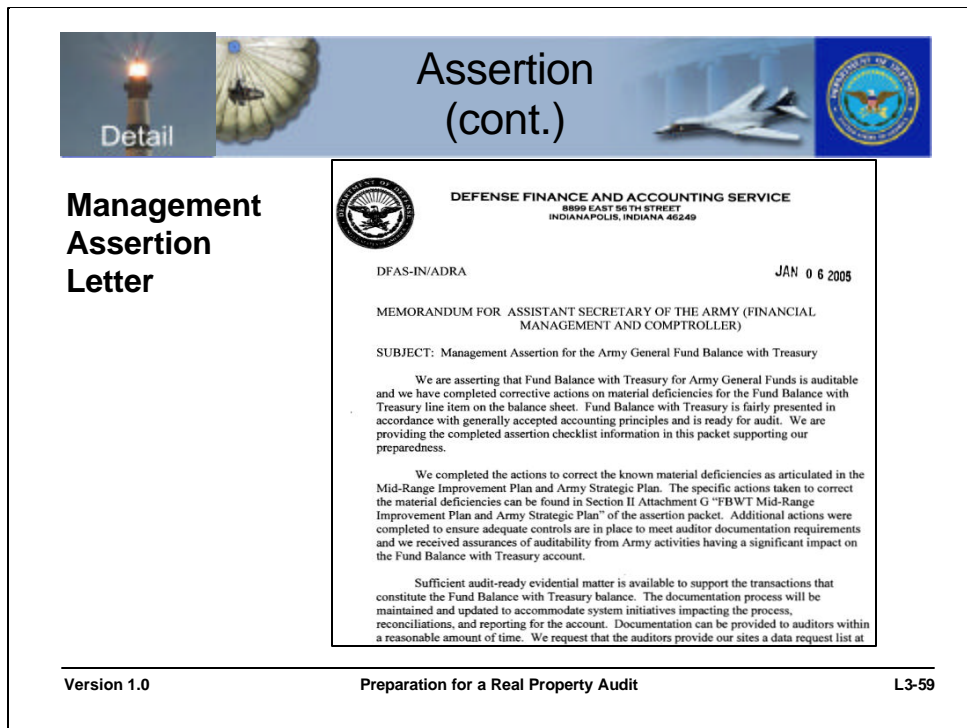
The assertion package is submitted to the DoD OIG, with a copy furnished to the OUSD(C) POC, who forwards it to the RPS.

The assertion package contains:

- the management assertion letter
- a summary of the validation work performed that contains an explanation of actions taken by management to resolve deficiencies, and reports resulting from validation
- the assertion checklist completed during the Validation Phase.

If the entity prepares an engagement letter or a management representation letter for the DoD OIG, subsequent representation letters should reflect management's assertions in them.

Let's look at each of these documents.





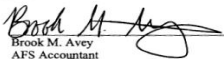
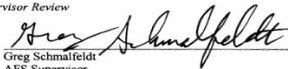

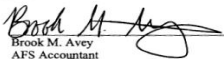
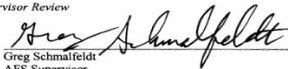

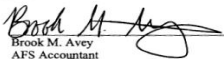
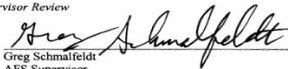



In this example of a management assertion letter, the Director, Accounting Services Army, is asserting that the Fund Balance with Treasury (FBWT) for the Army General Fund is auditable and that material deficiencies concerning that line item have been corrected. The assertion also states that the line item is presented fairly in accordance with Generally Accepted Accounting Principles (GAAP) and is ready for audit.

The letter states that the items included in the assertion packet support this assertion.

An assertion letter contains the required assurance that sufficient audit-ready evidential matter is available to support the transactions that constitute the Fund Balance with Treasury, and the assurance that sufficient knowledgeable staff is available to support audit requests during audit fieldwork.





The next item is the Validation information. It includes a Validation Certification and the Validation Summary. Let's look at these documents.

		<h2>Assertion (cont.)</h2>																														
<h3>DFAS-IN Validation Certification</h3>		<table border="1" style="width: 100%;"> <tr> <td colspan="2" style="text-align: left;">DFAS-INDIANAPOLIS</td> <td colspan="2" style="text-align: right;">SECTION VI VALIDATION CERTIFICATION</td> </tr> <tr> <td style="width: 50%;">Client</td> <td colspan="2" style="width: 30%;"></td> <td style="width: 20%;">Date</td> </tr> <tr> <td>Army General Funds</td> <td colspan="2"></td> <td>January 3, 2005</td> </tr> <tr> <td colspan="4"> <p>This document is to inform the Under Secretary of Defense (Comptroller), Department of the Army, and Department of Defense Inspector General that the FBWT assertion packet meets all of the requirements set forth in the Under Secretary of Defense (Comptroller) memorandum "Financial Improvement Business Rules," dated June 23, 2004 and "Financial Improvement Initiative Assertion Package Criteria and Organization," dated November 15, 2004. All supporting documentation has been compiled and presented as required and is available to view on the DFAS e-portal project entitled "IN-Army Financial Statement Assertions".</p> </td> </tr> <tr> <td colspan="4"> <p><i>Preparer:</i></p> <p style="text-align: center;">  Brook M. Avey AFS Accountant </p> </td> </tr> <tr> <td colspan="4"> <p><i>Supervisor Review</i></p> <p style="text-align: center;">  Greg Schmalfeldt AFS Supervisor </p> </td> </tr> <tr> <td colspan="4"> <p><i>Director of Departmental Accounting Review:</i></p> <p style="text-align: center;">  Cindy Garcia Director of Departmental Accounting </p> </td> </tr> </table>			DFAS-INDIANAPOLIS		SECTION VI VALIDATION CERTIFICATION		Client			Date	Army General Funds			January 3, 2005	<p>This document is to inform the Under Secretary of Defense (Comptroller), Department of the Army, and Department of Defense Inspector General that the FBWT assertion packet meets all of the requirements set forth in the Under Secretary of Defense (Comptroller) memorandum "Financial Improvement Business Rules," dated June 23, 2004 and "Financial Improvement Initiative Assertion Package Criteria and Organization," dated November 15, 2004. All supporting documentation has been compiled and presented as required and is available to view on the DFAS e-portal project entitled "IN-Army Financial Statement Assertions".</p>				<p><i>Preparer:</i></p> <p style="text-align: center;">  Brook M. Avey AFS Accountant </p>				<p><i>Supervisor Review</i></p> <p style="text-align: center;">  Greg Schmalfeldt AFS Supervisor </p>				<p><i>Director of Departmental Accounting Review:</i></p> <p style="text-align: center;">  Cindy Garcia Director of Departmental Accounting </p>			
DFAS-INDIANAPOLIS		SECTION VI VALIDATION CERTIFICATION																														
Client			Date																													
Army General Funds			January 3, 2005																													
<p>This document is to inform the Under Secretary of Defense (Comptroller), Department of the Army, and Department of Defense Inspector General that the FBWT assertion packet meets all of the requirements set forth in the Under Secretary of Defense (Comptroller) memorandum "Financial Improvement Business Rules," dated June 23, 2004 and "Financial Improvement Initiative Assertion Package Criteria and Organization," dated November 15, 2004. All supporting documentation has been compiled and presented as required and is available to view on the DFAS e-portal project entitled "IN-Army Financial Statement Assertions".</p>																																
<p><i>Preparer:</i></p> <p style="text-align: center;">  Brook M. Avey AFS Accountant </p>																																
<p><i>Supervisor Review</i></p> <p style="text-align: center;">  Greg Schmalfeldt AFS Supervisor </p>																																
<p><i>Director of Departmental Accounting Review:</i></p> <p style="text-align: center;">  Cindy Garcia Director of Departmental Accounting </p>																																
Version 1.0		Preparation for a Real Property Audit		L3-60																												

In this example of the DFAS-Indianapolis Validation Certification, the preparer, reviewers, and other members of management have annotated with their signatures that the FBWT assertion packet meets all of the requirements set forth in the USD(C) memorandum concerning the Financial Improvement Initiative Business Rules and the memorandum subject Assertion Package Criteria and Organization.

They assert that all supporting documentation has been completed and presented as required and is available to view on the DFAS ePortal.

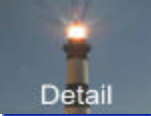



Now let's look at the Validation Summary.

	 <h2 style="text-align: center;">Assertion (cont.)</h2> 					
<h3>Validation Summary</h3>	<div style="display: flex; justify-content: space-between;"> DFAS-Indianapolis Executive Summary – FBWT Assertion Packet </div>					
	<table border="1" style="width: 100%;"> <tr> <th style="text-align: left;">Client</th> <th style="text-align: left;">Date</th> </tr> <tr> <td>Army General Funds</td> <td>November 30, 2004</td> </tr> </table>		Client	Date	Army General Funds	November 30, 2004
	Client	Date				
	Army General Funds	November 30, 2004				
<p>Defense Finance and Accounting Service - Indianapolis (DFAS-IN) is asserting that the Army General Fund (GF) Fund Balance with Treasury (FBWT) is ready for audit and balances reported in the quarterly and year-end financial statements are fairly presented in accordance with generally accepted accounting principles. Over the past five years the Department of the Army and DFAS have implemented several initiatives to improve the accountability over the execution and reporting of FBWT. These initiatives improved controls, increased the efficiency and timeliness of recording undistributed disbursements and collections in accounting systems, improved documentation, and reduced risk in the financial reporting process. These actions have put Army in a position that with alternative auditing procedures the FBWT Balance Sheet line item (\$89.5 billion) is ready for an audit.</p>						
<p>Composition of FBWT The Army receives the majority of funds in the form of direct appropriations (\$149.6 billion), as passed by Congress in the Annual Appropriation Acts passed by Congress. These are apportioned by the Office of Management and Budget (OMB), and recorded on the basis of the U. S. Treasury issuing a Warrant to the Army. The funding business rules impacting FBWT have been a uditable for a number of years. The Army's FBWT is decremented, or supplemented by reimbursable activity (\$21.4 billion), by the recording of disbursements and collections at the U. S. Treasury. DFAS has implemented several improvements since FY 2000 to ensure the timely recording of disbursements and collections (Net Outlays \$130.2 billion) and to improve documentation. These actions lead the Army and DFAS to consider the FBWT to be considered auditable.</p> <p>Improved Controls The Army Disbursing Network originally consisted of over 80 disbursing activities processing over 200 fiscal stations. This structure caused enormous inconsistencies in business practices, large reconciliation issues, and minimal management control. To improve control, the network was consolidated into two</p>						
Version 1.0	Preparation for a Real Property Audit		L3-61			

The Validation Summary outlines the corrective actions taken to improve accountability, controls, efficiency, timeliness, and documentation for the fund or balance being reported. It then states that the item is ready for an audit.

This may provide an overview of the fund prior to listing specific actions performed by the entity to prepare the fund or balance for audit. This is an area where accomplishments of the entity are highlighted and good report writing is essential.

Let's talk about the completed assertion checklist.

  <h1>Assertion (cont.)</h1>  							
<h2>Assertion Checklist</h2>	<div> <div>DFAS-Indianapolis</div> <div>Section III Assertion Packet Checklist</div> </div> <table border="1"> <thead> <tr> <th>Prepared by</th> <th>Client</th> <th>Date</th> </tr> </thead> <tbody> <tr> <td>Brook Avey</td> <td>Army General Funds</td> <td>November 30, 2004</td> </tr> </tbody> </table>	Prepared by	Client	Date	Brook Avey	Army General Funds	November 30, 2004
	Prepared by	Client	Date				
	Brook Avey	Army General Funds	November 30, 2004				
<div> <input checked="" type="checkbox"/> <p>Identify and document the procedures, processes, and control point for deriving the balances being asserted. Include the systems that are used and the flow of data from field level to departmental level.</p> <p>RESPONSE: The procedures, processes, and control points are documented in the Process Analysis Document (PAD) and the Audit Folders. The PAD provides a high level overall flow of the Fund Balance with Treasury (FBWT) processes, information on the computer systems used, and process-level risks and controls. See Attachment A for a copy of the PAD. In addition, the Assertion Folders provide detailed documentation on each of the individual processes within the PAD to include listings of the incoming and outgoing reports, point of contacts, control points, risk areas, assumptions, and examples. See Attachment B for a list of all the Assertion Folders. Due to the volume, the folders are included in the assertion packet on the CD and on the DFAS e-portal project entitled "IN-Army Financial Statement Assertions."</p> <p>In addition, Attachment C provides a methodology for audit planning. This provides suggestions for planning the FBWT audit based on requirements set in the Governmental Accountability Office Financial Audit Manual and DFAS knowledge.</p> </div>							
<div> <input checked="" type="checkbox"/> <p>1. Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements</p> <p>RESPONSE: Attachment D provides a list of all the transaction files, the POC, the location of _.</p> </div>							

Version 1.0

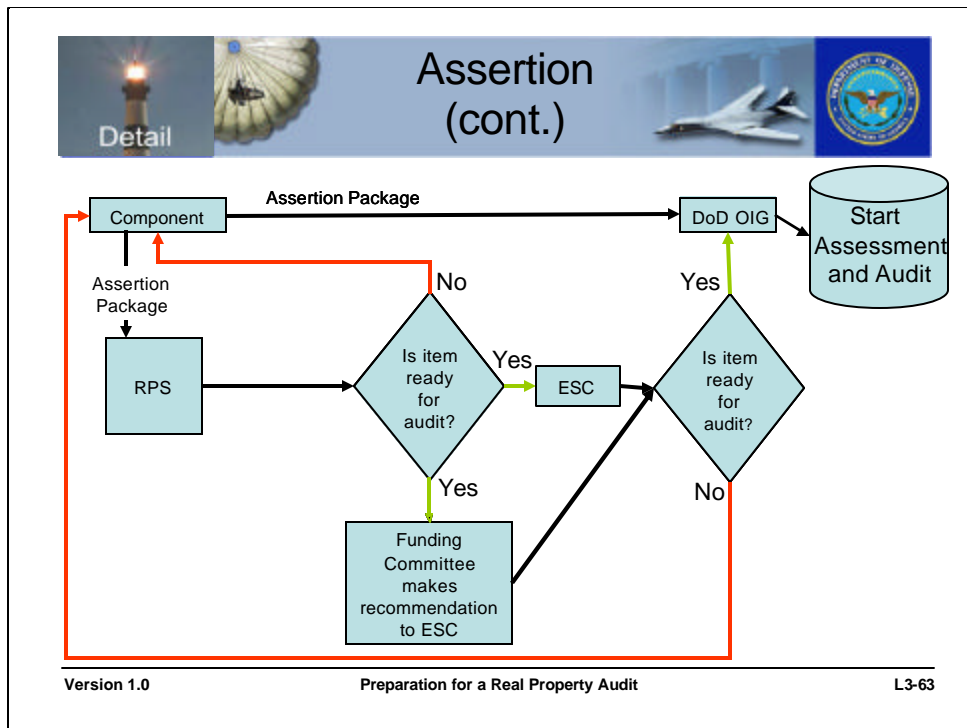
Preparation for a Real Property Audit

L3-62

The completed assertion checklist provides a description of each topic and the entity's response to the requirements for its validation.

Notice above that the entity identified the items required from the checklist which included documenting the procedures, processes, and control points for deriving the balances being asserted. The corresponding response states the specific document and location where the procedures, processes, and controls are documented.

Now let's discuss the distribution of and action taken on these documents.



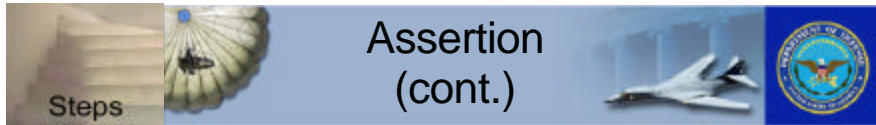
The Component simultaneously submits the assertion package to the RPS and the DoD OIG. The DoD OIG is a non-voting member of the RPS and the ESC. It provides valuable input into the review of the assertion packages to include assessment and audit cost estimates.

If the RPS determines that the assertion package is audit-ready, it is simultaneously submitted to the Funding Committee and the ESC with the RPS's prioritized recommendations concerning assessment and audit schedules.

The ESC, with the Funding Committees' recommendation, reviews the assertion package for audit readiness. If audit-ready, the package is forwarded to the DoD OIG for audit. Once the DoD OIG receives the approved package from the ESC, it may begin the assessment and audit.

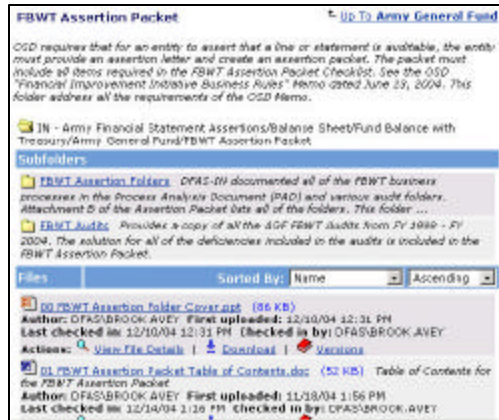
If the RPS or ESC makes a determination that the assertion package is not audit-ready, it is returned to the submitting Component.

Let's discuss ideas on how to organize those documents.



Develop a method of organized folders.

Army Financial Statements Assertions are on the DFAS ePortal.



Version 1.0

Preparation for a Real Property Audit

L3-64


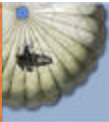
It is important to develop a method of organized folders so that all assertion data can be retrieved and reviewed quickly and efficiently.

An example of this process is the Army Financial Statement Assertions on the DFAS ePortal. Folders are set up for each of the affected financial statements. Within each statement folder, subfolders are set up for various line items such as Accounts Payable, Cash, FBWT, and others.



The line items are further subdivided by fund or other applicable division. In the case of FBWT, it is subdivided into folders for the Army General Fund and the Army Working Capital Fund. Once the fund is selected, a subfolder containing FBWT assertion packet information may be opened.

Subfolders in this area are divided into assertion or audit files. Assertion files include a table of contents file and numbered files that are labeled by section and title. Audit files are labeled by agency and title or report number of the audit reports.

Now let's examine the Assessment Phase.

Assessment

Assessment Phase:

The DoD OIG reviews financial information to determine if it is ready for audit.

Why	How
Implement 1008, allows remediation, attests to management assertion, plan audit, reduce risk of unknowns to auditor, auditors' introduction to organization	DoDIG oversight of IPAs or DoDIG in-house assessments

Version 1.0

Preparation for a Real Property Audit

L3-65

The Assessment Phase determines the reliability of the line item or financial statement that the entity asserts as being ready for audit.

This assessment is substantially less than an audit, but sufficient enough to verify that the corrective actions implemented during the Discovery and Correction Phase successful.

Assessment is generally done first if a statement has never been audited. Assessment occurs when the DoD OIG believes circumstances may exist that will cause the entity to obtain an opinion other than unqualified. An example of such a situation is a system of internal control allowing for the disbursement of funds without proper certification. In this case, the DoD OIG determines that an assessment is necessary to ensure reliability as required per Section 1008. During the Assessment Phase, an entity performs a remedy in the event a deficiency is identified preventing an unqualified opinion.

Let's continue with this phase.



Assessment (cont.)



The scope of the assessment consists of accomplishing the audit steps outlined in the Planning Phase and Internal Control Phase of the FAM.



Version 1.0

Preparation for a Real Property Audit

L3-66

The Assessment Phase is performed by the DoD OIG, or by an IPA contracted to perform work for the DoD OIG. The scope of the assessment is determined in accordance with the GAO/PCIE FAM and consists of accomplishing the audit steps outlined in the Planning Phase and Internal Control Phase. The assessment process determines whether the entity can likely achieve an unqualified audit opinion. If it is determined that circumstances or problems exist that preclude an unqualified opinion, a report is written to management that describes what has prevented the auditor from obtaining sufficient, reliable, and competent information. The report recommends to management what needs to be accomplished to remedy the problems.

The Assessment Phase is used as part of the DoD OIG's audit strategy to reduce risks of the unknown and introduce new auditors to the entity's processes. Progress is reviewed and monitored by management and the entity's audit committee through regularly scheduled interim progress reports. Management informs its OUSD(C) POC of any new deficiencies identified. There is continued communication, both written and oral, as the assessment progresses. Management should take actions to correct problems identified during the assessment. The DoD OIG recommends when it is appropriate to move forward with a formal audit.

Let's look at a few of the audit steps outlined in the Planning and Internal Control Phases of the audit manual.



Assessment (cont.)



FAM Planning Phase

200	PLANNING PHASE
210	Overview
220	Understand the Entity's Operations
225	Perform Preliminary Analytical Procedures
230	Determine Planning, Design, and Test Materiality
235	Identify Significant Line Items, Accounts, Assertions, and RSSI
240	Identify Significant Cycles, Accounting Applications, and Financial Management Systems
245	Identify Significant Provisions of Laws and Regulations
250	Identify Relevant Budget Restrictions
260	Identify Risk Factors
270	Determine Likelihood of Effective Information System Controls

Version 1.0

Preparation for a Real Property Audit

L3-67

The Planning Phase requires auditors to gain an understanding of the entity's operations, perform preliminary analytical procedures, and determine planning, design, and test materiality. Auditors must also identify significant line items, accounts, and assertions. In gaining an understanding of the entity's operations, auditors identify significant cycles, accounting applications, and financial management systems. They also familiarize themselves with the provisions of laws and regulations, and budget restrictions. Auditors evaluate risk factors and determine the likelihood of effective information systems controls, then identify relevant operations controls to evaluate and test.

As the entity being reviewed, it is important to know you are critical to the success of the audit. By showing that you know your role in the process, manage your business well, that transactions are recorded accurately and timely, and that you can substantiate your transactions, you assist in creating a clean and sound audit trail.

Let's consider the identification of significant cycles, accounting applications, and financial management systems as listed in this manual.



Assessment (cont.)



FAM Planning Phase (cont.)

Planning Phase

240 - IDENTIFY SIGNIFICANT CYCLES, ACCOUNTING APPLICATIONS, AND FINANCIAL MANAGEMENT SYSTEMS

- .01 In the internal control phase, the auditor evaluates controls for each significant cycle and accounting application and determines whether significant financial management systems substantially comply with federal financial management systems requirements, federal accounting standards, and the SGL at the transaction level. A cycle or an accounting application should be considered significant if it processes an amount of transactions in excess of design materiality or if it supports a significant account balance in the financial statements or significant RSSI. A financial management system generally consists of one or more accounting applications. If one or more of the accounting applications making up a financial management system are considered significant, then that financial management system generally should be considered significant for determining whether the system substantially complies with FFMA requirements. The auditor may identify other cycles, accounting applications, or financial management systems as significant based on qualitative considerations. For example, financial management systems covered by FFMA include not only systems involved in processing financial transactions and preparing financial statements, but also systems supporting financial planning, management reporting, or budgeting activities, systems accumulating and reporting cost information, and the financial portion of mixed systems, such as benefit payment, logistics, personnel, and acquisition systems.
- .02 The entity's accounting system may be viewed as consisting of logical groupings of related transactions and activities, or accounting applications.

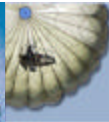
Version 1.0

Preparation for a Real Property Audit

L3-68

The FAM describes the identification of significant cycles, accounting applications, and financial management systems requirements by providing an overview of the auditors' duties as they relate to this item. It defines significance as it relates to each item and how the items are affected by both financial and non-financial systems. The auditor looks to the entity to provide the needed financial management information to satisfy this phase.

Now let's talk about the Internal Control Phase.



Assessment (cont.)



FAM Internal Control Phase

300	INTERNAL CONTROL PHASE
310	Overview
320	Understand Information Systems
330	Identify Control Objectives
340	Identify and Understand Relevant Control Activities
350	Determine the Nature, Timing, and Extent of Control Tests and of Tests for Systems' Compliance with FFMA Requirements
360	Perform Nonsampling Control Tests and Tests for Systems' Compliance with FFMA Requirements
370	Assess Controls on a Preliminary Basis
380	Other Considerations
390	Documentation

Version 1.0

Preparation for a Real Property Audit

L3-69

During the Internal Control Phase, the entity provides the documentation that supports your internal control program. It is important to understand that the auditor's role is to review your entity's program while your role is to ensure that the process moves smoothly and efficiently.

The Internal Control Phase requires auditors to gain an understanding of the entity's information systems, control objectives, and relevant control activities. They must determine the nature, timing, and extent of control tests and of tests for systems compliance with legal requirements. To determine the testing required, auditors perform control and compliance testing on a preliminary basis.

Let's take a closer look at identifying and understanding relevant control activities.



Assessment (cont.)



FAM Internal Control Phase (cont.)

Internal Control Phase

340 - IDENTIFY AND UNDERSTAND RELEVANT CONTROL ACTIVITIES

- .01 For each control objective, based on discussions with entity personnel, the auditor should identify the control activities designed and implemented to achieve the specific control objective.¹ Such controls may be recorded in the auditor's informal notes and/or interview write-ups for use in the following procedure, but each control activity need not be formally documented on the SCE worksheet at this time. The auditor should first screen the activities to identify those that are effective and efficient to test. An IS auditor may assist the auditor in identifying and understanding IS controls.

BASIC UNDERSTANDING OF EFFECTIVENESS OF CONTROL ACTIVITIES

- .02 The auditor should obtain a sufficient understanding of the identified control activities to determine whether they are likely to achieve the control objectives, assuming an effective control environment, risk assessment, communication, and monitoring, appropriate segregation of duties, and effective general controls. The purpose of this assumption is to identify any weaknesses in the specific control activities that should be corrected. When other internal control components are poor, there is inadequate segregation of duties, or poor general controls preclude the effectiveness of specific control activities that would otherwise be effective, the testing of such specific control activities may be limited to determining whether such controls are in place. To accomplish this, the auditor might (1) discuss the cycle and specific controls with management and then (2) perform walkthroughs by observing the controls in place or examining several items

FACTORS TO CONSIDER

Version 1.0

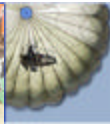
Preparation for a Real Property Audit

L3-70

Relevant control activities are described as those that are designed to achieve the specific control objective. The auditors first screen the activities to identify those objectives that are effective and efficient. They do this to obtain a sufficient understanding of the identified control activities. The auditor must determine whether he or she is likely to achieve the control objectives, assuming an effective control environment, risk assessment, communications, monitoring, appropriate segregation of duties, and effective general controls.

The auditor identifies any weaknesses in specific control activities that should be corrected. When internal control components are poor, there is inadequate segregation of duties, or poor general controls preclude the effectiveness of specific control activities that would otherwise be effective, the testing of these control activities may be limited to determining whether they are in place.

Let's examine a few practices that are particularly useful in the Assessment Phase.



Assessment (cont.)



Best Practices during the Assessment Phase

- **Know the audit process and the regulations**
- **Provide good training and awareness for all staff**
- **Change the mindset toward audits**
- **Know the auditor's checklist**
- **Staff resources to work with auditors**

Version 1.0

Preparation for a Real Property Audit

L3-71

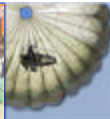
If you know the audit process and the regulations driving it, you can anticipate the auditor's requirements. It is important that good training and awareness for all staff is included in your assessment strategy. With adequate training on what is expected, you ensure that your people are ready for the audit.

You must lead a change in the mindset toward audits; they are not just for the financial community. You may set up a web site or have a newsletter. Frequent communication is necessary to convey expectations, goals, and direction.

When the auditors examine entity operations, you should know the auditor's checklist. You can then anticipate what is going to be needed and start early to have the audit move quickly and have less disruption of business operations.

Successful organizations ensure that they have adequate resources in place to assist in the audit effort. You must assign resources to work with auditors or hire contractors.

Let's continue with more best practices.



Assessment (cont.)



Best Practices during the Assessment Phase (cont.)

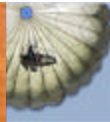
- **Have the right people in the jobs**
- **Have document retrieval methods documented**
- **Have consistent practices**

Having the right people in the jobs is critical to the audit effort. If not, the process slows down considerably. Auditors will ask the most available person questions concerning your entity's operations, controls, and procedures. You must ensure that the most available person is also the most knowledgeable person.

Document retrieval methods may be established for both paper and electronic documents. You must have document retrieval methods established and documented, especially for historical data. Ledgers containing all transactions should be ready and should include all documentation and back-up matter. This matter may include purchase orders, invoices, receiving reports, and other essential documentation. This source documentation may be located in several different offices. It must be pulled together to support the financial records.

Auditors are looking for consistent practices that are within established guidelines.

Let's move on to the Audit Phase.



Audit



Audit Phase:

The DoD OIG audits the organization's financial statements that management asserted were ready for audit and that passed the DoD OIG assessment.

Why	How
Implement CFO Act, implement 1008, Presidents' Management Agenda.	Pass assessment, DoDIG oversight of IPAs or DoDIG in-house audits

The purpose of the Audit Phase is to obtain an auditor's opinion of the condition of an entity's financial statement or line and the fairness of the presentation of the information in the financial statements. When a financial statement or portion thereof is asserted to be ready for audit and has passed assessment, or assessment has been waived, the DoD OIG determines the appropriate scope and nature for a financial audit and the associated reports.

Let's learn more about this phase.



Audit (cont.)



The scope of the Audit Phase consists of accomplishing the audit steps outlined in the Testing Phase and Reporting Phase of the FAM.



Version 1.0

Preparation for a Real Property Audit

L3-74

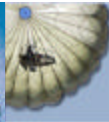
During the Audit Phase, the entity and its accounting records are audited to determine if the balances and related notes presented on its financial statements fairly represent the operations of the entity.

With the assistance of the DoD OIG, DoD reporting entities prepare detailed engagement letters requesting audit services. The auditors then require any management representations made to date that concern the items to be included in the audit. DoD reporting entities prepare as many interim management representation letters as necessary to include any additional assertions required by the audit. They then prepare a final management representation letter.

Management personnel address deficiencies with a written plan for resolution, including projected resolution date. The DoD OIG intervenes if necessary to end the audit and recommends a follow-up assessment upon indication that the audit may not have a favorable outcome.

The scope of the Audit Phase consists of accomplishing the audit steps outlined in the Testing Phase and Reporting Phase of the audit manual.

Let's look at a few of these steps.



Audit (cont.)



Testing Phase:

- **Auditors consider the nature, timing, and extent of tests**
- **Tests must provide the greatest benefit for the least amount of time and resources**

400	TESTING PHASE
410	Overview
420	Consider the Nature, Timing, and Extent of Tests
430	Design Efficient Tests
440	Perform Tests and Evaluate Results
450	Sampling Control Tests
460	Compliance Tests
470	Substantive Tests – Overview
475	Substantive Analytical Procedures
480	Substantive Detail Tests
490	Documentation

Version 1.0

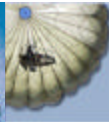
Preparation for a Real Property Audit

L3-75

The Testing Phase consists of a consideration of the nature, timing, and extent of tests to be performed on the evidentiary matter associated with the audit. The auditor must design efficient tests that provide the greatest benefit for the least amount of time and resources. The auditor must then perform those tests and evaluate results. Several types of testing are available and are explained within the Financial Audit Manual. The How to Manage Audit Evidential Matter course provides additional information concerning audit testing methods.

Once testing is completed, the auditor must document the results in order to ensure that adequate audit procedures have been accomplished.

Let's look at the requirement for performing tests and evaluating results.



Audit (cont.)



Testing Phase (cont.):

- **Evaluate the results of each type of test separately**
- **Tests performed with the expectation of obtaining certain results may give other results**

Testing Phase

440 - PERFORM TESTS AND EVALUATE RESULTS

- .01 The auditor should perform the planned tests and should evaluate the results of each type of test separately, without respect to whether the items were chosen as part of a multipurpose test. Guidance on performing and evaluating the results is presented for each type of test in the following sections
- Section 450 - Sampling control tests,
 - Section 460 - Compliance tests, and
 - Section 470 - Substantive tests.
- .02 Sometimes, tests performed with the expectation of obtaining certain results give other results. When this happens, the auditor may wish to expand a sample to test additional items. Unless planned for in advance, this generally cannot be done simply, as discussed in paragraphs 450.17, 460.02, and 480.28; the auditor should consult with the Statistician in such cases.





Version 1.0

Preparation for a Real Property Audit

L3-76

The FAM states that the auditor should perform the planned tests and should evaluate the results of each type of test separately, without respect to whether the items were chosen as part of a multipurpose test. It states that sometimes, tests performed with the expectation of obtaining certain results give other results. When this happens, the auditor may wish to expand a sample to test additional items. Unless planned for in advance, this generally cannot be done simply and the auditor should consult with a statistician.

Let's discuss the Reporting Phase now.

  Audit (cont.)  		
Reporting Phase	500	REPORTING PHASE
	510	Overview
	520	Perform Overall Analytical Procedures
	530	Determine Adequacy of Audit Procedures and Audit Scope
	540	Evaluate Misstatements
	550	Conclude Other Audit Procedures <ul style="list-style-type: none"> • Inquiries of Attorneys • Subsequent Events • Management Representations • Related Party Transactions
	560	Determine Conformity With Generally Accepted Accounting Principles
	570	Determine Compliance With GAO/PCIE Financial Audit Manual
	580	Draft Reports
Version 1.0 Preparation for a Real Property Audit L3-77		

The Reporting Phase requires the auditor to perform overall analytical procedures. This does not mean that all testing must be re-done, but that the results of all of the testing must be analyzed in order to formulate conclusions. The auditor must also determine the adequacy of audit procedures and the audit scope in the formulation of these conclusions.

Misstatements are evaluated for their severity. If material, they may affect the overall opinion of the auditor. Other audit procedures include inquiries of the attorneys who represent the entity. Auditors must determine whether there are any pending liabilities that were not adequately disclosed in the notes to the financial statements.

The auditor must determine whether the presentation of the financial statements is in conformity with GAAP and whether the entity is in compliance with the FAM. The auditor then drafts reports on the financial statements, internal control, financial management systems, and compliance with laws and regulations.

Let's expand on the drafting of these reports.



Audit (cont.)



Reporting Phase (cont):

Auditors' reports include conclusions on:

- Financial statements
- Internal control
- Compliance with laws, requirements, and standards

Reporting Phase

580 - DRAFT REPORTS

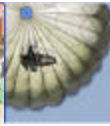
- .01 At the conclusion of the audit, the auditor finalizes the draft of the auditor's report(s), which includes the auditor's conclusions on
- the financial statements (see paragraphs 580.10-.31);
 - internal control (see paragraphs 580.32-.61);
 - whether the financial management systems substantially comply with the requirements of FFMIA: federal financial management systems requirements, federal accounting standards (GAAP), and the SGL at the transaction level (see paragraphs 580.62-.66); and
 - compliance with laws and regulations (see paragraphs 580.67-.75);
 - the MD&A (see requirements in SFFAS No. 15) and other information included in the Accountability Report (including RSSI) (see paragraphs 580.76-.81).
- .02 The auditor's report should clearly identify the entity audited, the Accountability Report on which the auditor is reporting, and the period covered by the Accountability Report.
- .03 The report should be dated as of the completion of fieldwork. If a subsequent event occurs after that time that requires disclosure in the report, the auditor should follow the guidance in AU 530 with respect to dating the

At the conclusion of the audit, the auditors finalize the draft of the reports. They include the auditors' conclusions on the financial statements, internal control, and system compliance with requirements of the FFMIA, federal financial management systems requirements, federal accounting standards, and the Standard General Ledger (SGL) at the transaction level. They also include the auditors' conclusions on the entity's compliance with laws and regulations.

The auditors' report should clearly identify the entity audited, the accountability report on which the auditor is reporting, and the period covered by the accountability report. It should then be dated as of the completion of fieldwork.

The final report is based upon the financial documents that the entity provided. If the information is inaccurate or incomplete, the report may mistakenly portray an unfavorable picture of the entity.

Let's consider a few best practices.



Audit (cont.)



Best Practices during the Conduct of the Audit

- **Plan the entrance conference**
- **Maintain communications with POCs and employees**
- **Monitor information consistently and keep track**

Version 1.0

Preparation for a Real Property Audit

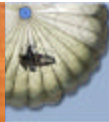
L3-79

An audit should contain no surprises. Once you have engaged an auditor, you must plan for the entrance conference. Ensure that adequate and knowledgeable staff is available, that adequate time is scheduled without interruption, and that a congenial atmosphere is maintained. Be familiar with the areas to be audited and know the procedures used to test those areas.

You must communicate audit requirements with your POCs and employees to ensure a smooth audit process. Knowledgeable personnel must be available to the auditor throughout the audit. By having a proper escort, the auditor's questions are likely to be answered correctly, and there is less likelihood of delays in the conduct of the audit.

Information obtained in the audit process should be monitored, appropriately catalogued, and filed for immediate or later action.

Let's look at some checklists and measurements for audits.



Establishing Accountability



Checklists and Measurements for Audits

- **Establishing accountability**
- **Metrics and templates**
- **DoD Financial Management Regulation (DoDFMR), Volume 6B, Appendix B**
- **GAO/PCIE FAM Checklist for Federal Accounting, Reporting, and Disclosure**
- **Balance Sheet**
- **Note 10**

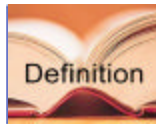
Version 1.0

Preparation for a Real Property Audit

L3-80

These are the checks and measurements used for audits. We discuss each of these in detail.

Let's begin this topic discussing how to establish accountability.



Establishing Accountability (cont.)



What are metrics?






Metrics are used to develop realistic estimates and plans, to objectively track and communicate program and project status, and to anticipate problems or identity risks.

Metrics are actionable and tangible measurements that support objectives and demonstrate an entity's accountability. They include objectives, measures, and targets.

The objectives define what the entity needs to do in order to accomplish its strategy. Measures are the metrics and the targets are the performance level expectations. For each metric, the Department should set a goal or plan so the progress against the objective can be evaluated.

Tracking metrics provides historical data to help plan and predict future programs/projects and provides baseline information to support decision making.

Let's take a look at metrics and measurements for a physical inventory of real property.

<div>   <div>Establishing Accountability (cont.)</div>   </div>				
<div> Real Property Physical Inventory of Real Property March 2005 Data </div>				
Definition	Long-Term Goal	FY 2005 Goal		Scoring Methodology
Metric I.1.3.PP.B.1.A BSC Category: Financial Perspective: QDR Risk Category: Institutional Series: Financial Operations: Type: Quality Source of Data: Custom Data Call from A&FP&A to the DoD Components. Systems and databases will be disclosed at a later date. Definition: This metric displays the Department's progress in completion of its physical inventory of Real Property. The DoD Components are required to conduct 100% physical inventory every 5 years. Importance: Verification of existence & completeness is required for the Department assert on Real Property.	Goal: To ensure that a 100% physical inventory is completed on Real Property. FY 2005 – 30 % Complete FY 2006 – 60 % Complete FY 2007 – 100 % Complete	Score: 0  Red	Goal: Complete 30% of physical inventory. Results: (Action: Component data needs to be gathered & analyzed)	Scoring Criteria: Based on quarterly reporting. Scoring is based on quantities of Real Property owned by the DoD Components and divided that by the quantity that has had a 100 % physical inventory completed. 30% Reconciliation 10-Green 27% Reconciliation 9-Green 24% Reconciliation 8-Green 21% Reconciliation 7-Yellow 18% Reconciliation 6-Yellow 15% Reconciliation 5-Yellow 12% Reconciliation 4-Yellow 9% Reconciliation 3-Red 6% Reconciliation 2-Red 3 % Reconciliation 1-Red 0% Reconciliation 0-Red POCs: A&FP&A: Tom Waddell (703) 604-6350 Ext 134 PME: Audrey Clark (703) 695-0419
Version 1.0	Preparation for a Real Property Audit			L3-82

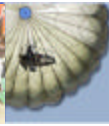
You can see an example of how metrics and measurements are established for a physical inventory of real property. We are translating the Department's vision and strategy into a set of measures set around the financial perspective. This metric displays the Department's progress in completion of their physical inventory of real property.

The DoDFMR requires that a 100% physical inventory of real property is conducted every five years. It's necessary to establish the existence and completeness of the real property inventory for the Department to make an assertion for the real property.

In this example, the Department is ensuring a 100% completed physical inventory of real property in three years. There are targets established for FYs: 2005, 2006, and 2007. For example, in FY 2005, the Department's goal is to complete 30% of the physical inventory of real property. In FY 2006, the inventory should be 60% completed. While in FY 2007, the inventory should be 100% complete.

The scoring criteria is in the last column. For example, in FY 2005, the goal is 30% completion. There is a range for 0% to 30%. Within this range, there is a scoring scale of red, yellow, and green based on the percentage of completion.

Let's look at some key requirements to establish a Balanced Scorecard.



Establishing Accountability (cont.)



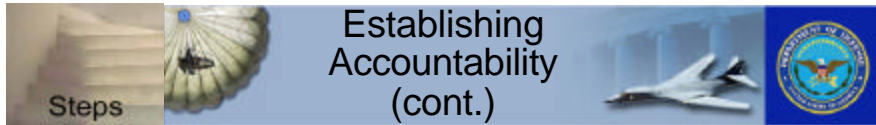
In order to establish accountability of real property, we need to establish:

- **Strategy**
- **Objectives**
- **Metrics and measures**
- **Implementation plan**

When establishing accountability, you need to start with a strategy and progressively break that strategy into objectives and measures. You establish targets for achieving management's objectives and goals that contribute to the overall mission of the Department.

High goals set for real property accuracy rates is one way of establishing accountability for the physical count of real property. When high goals are set for accuracy, such as 95 percent to 98 percent, organizations and personnel usually perform counts with increasingly superior precision.

Let's look at some key factors to achieve consistent and accurate counts of real property.



Establishing Accountability

- **Establish accountability**
- **Establish written policy**
- **Select an approach**
- **Count frequently**
- **Segregate duties**
- **Have a knowledgeable staff**
- **Provide adequate supervision**
- **Ensure completeness of counts**
- **Execute physical counts**
- **Perform research**
- **Evaluate count results**

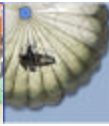
Version 1.0

Preparation for a Real Property Audit

L3-84

These are the steps in order to establish accountability of real property. We establish a performance goal accuracy rate from 95 percent to 98 percent to better account for real property. We are going to look at these different steps.

Let's look at ways for establishing accountability.



Establishing Accountability (cont.)



Establishing Accountability

- High goals
- Accurate counts
- Proper planning



Version 1.0

Preparation for a Real Property Audit

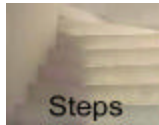
L3-85

We mentioned before that high goals are set for a physical count of real property. Most experts agree that an accuracy rate of 95 percent or more should be set. Real property assets such as land, buildings, and structures must be properly accounted for in property and financial management systems. Therefore, we have two goals during this process. First is the accountability of the real property; second is to ensure that the real property not accounted for is placed on accountable records.

The appropriate level of management should be responsible and answerable for the overall real property inventory process. This is essential to achieving consistently accurate counts. The accountability of real property should exist from the top of the organization to the lowest level. However, responsibility for the overall physical count should be specifically designated and assigned.

The appropriate level of management has specific responsibility to for planning the count, organizing the teams, reviewing the counts, reviewing research, and approving adjustments within established tolerances. These individuals are responsible for achieving the Department's performance goals, including inventory record accuracy, through personnel performance expectations and evaluations.

Let's discuss written procedures.



Establishing Accountability (cont.)



Written procedures include:

- Objectives of the real property inventory
- Tasking (assigned personnel)
- Reconciliation procedures (not on records)
- Computer access
- Frequency of counts
- Real property classification (General PP&E, Heritage Asset, Stewardship)

Version 1.0

Preparation for a Real Property Audit

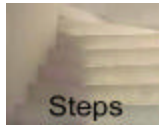
L3-86

During this process, the establishment of documenting policies and procedures is essential to an effective and reliable physical count of real property. There should be clear communication, comprehensive instructions, and specific guidelines for the count.

Written policies and procedures help ensure consistent and accurate compliance needed to achieve the highest level of integrity and accuracy in the physical count process. The policies and procedures are the basis for providing training and informing personnel.

The review process is important to reflect any change to the mission or regulatory guidance such as the reclassification of National Defense PP&E to General PP&E.

Let's select an approach.



Establishing Accountability (cont.)



Select an Approach

- **Cycle counting is a method by which a portion of the inventory is counted either daily, weekly, or monthly, until the entire real property is counted over a period of time.**
- **Wall-to-wall inventory is a method to count the entire inventory at a point in time at least every five years.**



Version 1.0

Preparation for a Real Property Audit

L3-87

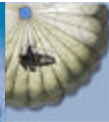
The process of counting physical inventory is an essential control for operational efficiency and financial reporting. During our count, we want to verify the existence of real property and the completeness and/or accuracy of financial and real property records. These inventory records are key to the Department's confidence in financial and other information used in decision-making. These are two methods.

- Cycle counting is a method by which a portion of the inventory is counted either daily, weekly, or monthly until the entire real property is counted over a period of time. This method serves two purposes: it supports the reliability of the on-hand inventory quantities used in management decisions and financial reporting, and it normally results in increased operational efficiency.
- Wall-to-wall inventory is a method to count the entire inventory at a point in time (as with real property) at least every five years. This method is primarily used for financial reporting purposes in order to validate the amount on the Balance Sheet and Footnote No. 10.

Key objectives of the real property count are:

- to establish a specific balance as of a specific date for financial reporting
- keep accurate records for financial reporting and management decisions
- update availability of assets to meet operational and mission needs
- identify excess or obsolete real property.

Let's talk about the frequency of counts.



Establishing Accountability (cont.)



Frequency of Counts

- **Selection of items to count**
- **Frequency of count**
- **Importance of high risk assets**
- **Every five years**
- **Real property records**

Version 1.0

Preparation for a Real Property Audit

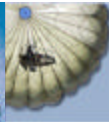
L3-88

In order to count an appropriate amount of the real property inventory, the Department must decide which real property items to count and how frequently to count those items. Maintaining accurate inventory records by counting the real property takes time and costs money.

The best way to balance the control of real property is to focus on the assets determined to be more important or of high risk to the organization. Management should exert the highest degree of control (frequent counts) on the most important assets, and the least control on the least important assets.

A physical inventory of all property, plant, and equipment real property is conducted at least once every five years, and that information is maintained on file in the real property records.

Let's move on to the segregation of duties.



Establishing Accountability (cont.)



Segregation of Duties

- **Physical custody of the assets**
- **Processing and recording of transactions**
- **Approval of the transactions**

Version 1.0

Preparation for a Real Property Audit

L3-89

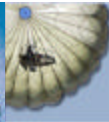
Segregation of duties is a commonly used and widely accepted internal control, and a good business practice. It entails the dividing or segregation of key duties among different personnel during the inventory of real property. Some key areas of segregation of duties include:

- physical custody of the assets
- processing and recording of transactions
- approval of the transactions.

In an ideal situation, the person having custody of the asset would not perform transaction recording and transaction approval. Personnel recording transactions that affect the on-hand balance should not be responsible for the physical custody of the inventory or approval of adjustments.

In some situations where segregation of duties is not practical or cost-effective, other controls are used to mitigate the recognized risk. These mitigating controls include blind counts (meaning the counter does not know how many items are there), increased supervision, and applying dual control by having activities performed by two or more people).

Let's discuss the knowledgeable staff who conduct the inventory.



Establishing Accountability (cont.)



Knowledgeable Staff

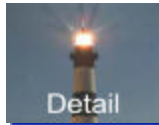
- **Experienced personnel**
- **Familiar with assets**
- **Trained**

During the real property inventory, the counters should be knowledgeable about the real property items counted. This leads to a more effective and accurate count of the assets. Experienced personnel are more familiar with the layout of the installation and/or activity and more familiar with the assets.

The personnel involved in the physical count of real property should be trained to perform the count. The type of training would depend on the type of count conducted.

A separate group of personnel conducting research and/or record adjustments are typically trained on researching variances, posting adjustments, and operating the property management system.

Let's discuss adequate supervision.



Establishing Accountability (cont.)



Key elements of adequate supervision include:

- Ensuring counters are available
- Selecting team members
- Assigning responsibilities
- Ensuring count is completed on time

Version 1.0

Preparation for a Real Property Audit

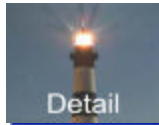
L3-91

A key factor of the physical count of real property is proper supervision. The supervision includes directing the efforts of personnel and determining that the objectives of the inventory count are accomplished. Key elements of supervision include:

- ensuring counters are available
- selecting team members
- assigning responsibilities
- ensuring count is completed on time.

Supervisors provide guidance to the counters prior to the inventory, during the inventory, and making sure they are following instructions. The amount of supervision depends on management's determination of the adequacies of segregation of duties. When performing wall-to-wall physical counts, supervision is key to accurate real property accountability.

Let's discuss the completeness of the count.



Establishing
Accountability
(cont.)



Ensure Completeness of Count

- **All items are counted**
- **Assets are controlled**
- **Assets are identifiable**

Version 1.0

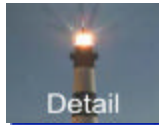
Preparation for a Real Property Audit

L3-92

A complete count requires that all items be counted, and control of the count be maintained so all assets that should be counted are counted.

During a count of assets, the property management system should be able to accurately capture and track transactions affecting the on-hand balances. All buildings or structures on an installation and/or facility are uniquely numbered and identifiable for inventory purposes.

Let's discuss some key areas during the count.



Establishing Accountability (cont.)



Five Key Areas while Executing the Count

- **Communication of the proper information to the counter**
- **Verification of correct item information**
- **Appropriate method to capture and compare to compare the physical count to the property records**
- **Determination of the number of counts to perform before the count, if accepted as final**
- **Completion of the count in a timely fashion**

Version 1.0

Preparation for a Real Property Audit

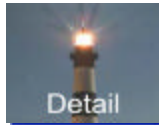
L3-93

Properly executing the physical count provides accurate results for the comparison of count to recorded balance, and the posting of adjustments to the real property records for financial and operational decision-making.

There are five key areas while executing the count:

- communication of the proper information to the counter
- verification of correct item information
- appropriate method to capture and compare to compare the physical count to the property records
- determine the number of counts to perform before the count if accepted as final
- timely completion of the count.

Let's discuss the perform research step.



Establishing Accountability (cont.)



Perform Research

- **Research differences**
- **Determine cause of differences**
- **Reconcile differences**

Version 1.0

Preparation for a Real Property Audit

L3-94

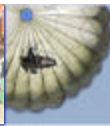
Even with a strong control environment and sound physical count procedures, there could be a difference in the quantities counted and the real property records. The cause for the difference is researched. Research of the cause, sometimes referred to as “root cause analysis,” and reconciliation of the differences is an essential element of an effective physical count of real property.

This process of research includes performing the required analysis, promptly completing research, and referring variances to management for approval and/or security for investigation.

Real property records require some research. For example, when real property was disposed of on a DA Form 337, Request for Approval of Disposal of Buildings and Improvements, was this asset removed from the accountable records? This indicates a difference between the accountable records and the inability to find this building.

If your installation and/or activity accepted military real property on a DD Form 1354, Transfer and Acceptance of Military Real Property, there could be a difference between the accountable records and the physical count if this asset was not recorded on the real property records.

Let's look at how to evaluate count results.



Establishing Accountability (cont.)



Evaluation of Count Results

- **Ensuring effective physical count**
- **Identifying any improvements to physical count**
- **Determining accuracy rate of physical count**

Version 1.0

Preparation for a Real Property Audit

L3-95

Evaluating the results of the physical count is essential to an accurate and effective count process of real property. The results provide management with the necessary information for measuring the effectiveness of the physical count, and required corrective actions or improvements to the inventory process and/or the property management system.

The results of the inventory of real property are measured in several ways. These could include calculating the inventory accuracy rate; summarizing the number and dollar value of the adjustments, errors, or items counted; and tracking and analyzing error code frequencies are ways to measure results.

When we created our Balanced Scorecard, we determined our strategy, objectives, metrics and measures, and how to implement it. After the inventory of real property is conducted, we compare the results versus the 95 percent accuracy that we established in the beginning.

Let's discuss the GAO/PCIE FAM Checklist.



Establishing Accountability (cont.)



GAO/PCIE FAM, Part II, Reporting 1050 – Checklist For Federal Accounting, Reporting, and Disclosures

Version 1.0

Preparation for a Real Property Audit

L3-96

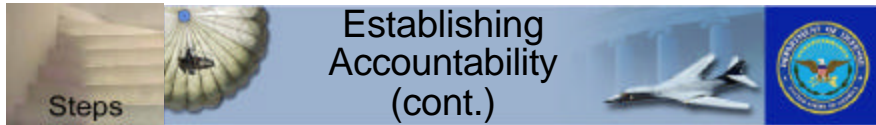
The CFOA and the GMRA requires that federal agencies' CFOs submit annual reports to their agency heads and to the OMB. These annual reports are to contain audited financial statements of their agencies. The statements should be in conformity with GAAP. This checklist reflects its potential application to any federal entity preparing annual audited financial statements.

This checklist contains 11 sections and is issued to assist agencies in preparing these statements and for auditors when auditing them. Although this checklist is not a requirement, it is intended to help provide for a systematic, organized, and structured approach to preparing or reviewing agency financial statements.

While the questions contained in the checklist are taken from authoritative sources, the checklist itself is not authoritative, nor is it a comprehensive guide. The preparers of the financial statements and the auditors should also consult financial management regulations for the individual agencies, as the regulations may have specific guidance when the standards allow alternatives or management flexibility.

For each question on this checklist, there is a reference to a specific source. The two source references are the Statements of Federal Financial Accounting Standards (SFFAS) and OMB Bulletin 01-09, Form and Content of Agency Financial Statements.

Let's discuss how to use this checklist



How to Use the GAO/PCIE FAM Checklist

- **Select the appropriate section in the checklist, for example, the Balance Sheet, Statement of Net Cost, or Notes to Financial Statements (Significant Accounting Policies)**
- **Analyze the question on the checklist**
- **Select the appropriate response and if necessary, provide an explanation**

Version 1.0

Preparation for a Real Property Audit

L3-97

The checklist has 11 sections:

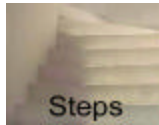
- an overview section
- a section related to general lines items in the financial statements
- a section for each of the six financial statements
- three additional sections.

The six sections reflecting the financial statements are organized by the line items in the financial statements to allow the user to proceed through each statement from the beginning to the end. The final three sections cover the disclosures in the notes to the financial statements related to significant accounting policies; required supplementary stewardship information and required supplementary information; and social insurance.

When using this checklist, there are three columns. The first column has the question, the second column contains the response to the question (Yes, No, or N/A), and the third column is for an explanation.

A “Yes” answer indicates that the financial statement contains the information asked by the question. A “No” answer indicates the information is not included in the financial statements, notes, or supplementary information. An “N/A” may not apply to your entity.

Let's see how we apply this checklist to real property.



Establishing Accountability (cont.)



Use of Checklist with Balance Sheet

Assets	Yes, No or N/A	Explanation
General Property, Plant, & Equipment (Net) (187-233)		
<i>General property, plant, and equipment (PP&E) are any property, plant, and equipment used in providing goods or services. (SPPAS 6, par. 20)</i>		
187. Has the entity established, checked, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (SPPAS 6, par. 13)		
188. Does the entity follow a policy that ensures its PP&E consists of tangible assets, including land, that meet the following criteria? a. have estimated useful lives of 2 years or more b. are not intended for sale in the ordinary course of operations c. are acquired or constructed with the intention of being used or being available for use by the entity (SPPAS 6, par. 17)		
189. Does PP&E consist of the following items? a. assets acquired through capital leases, including leasehold improvement b. property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, federal contractors) c. land rights (SPPAS 6 par. 15)		
<i>Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. Operating leases are leases in which the federal entity does not assume the risks of ownership of PP&E. Multiyear service contracts and multiyear purchase agreements for expendable commodities are not capital leases. (SPPAS 6, par. 20; footnote 22, SPPAS 5, par. 43)</i>		

Version 1.0

Preparation for a Real Property Audit

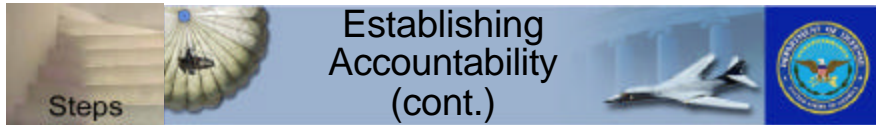
L3-98

During the time your agency was preparing annual financial statements, you determine that you should look at the checklist for the Balance Sheet and reviewed questions 187 through 233 on General PP&E.

When you provide a “No” answer, it may indicate a potential material weakness or a breakdown in internal control within an organization.

For example, if question 187 was answered with a “No” answer, it could indicate that your entity did not have adequate procedures in place to properly establish, disclose, or consistently follow appropriate capitalization thresholds for PP&E.

Let’s look at an example of a checklist for the Statement of Net Cost.



Use of Checklist with Statement of Net Cost

Costs	Yes, No or N/A	Explanation
Property, Plant, and Equipment (101 - 117)		
<i>A common expense related to PP&E that is included in the Statement of Net Cost is depreciation. Other PP&E-related expenses that are reported in the Statement of Net Cost include all current cost of acquiring and maintaining the ownership, land and heritage assets (other than multiple heritage assets). (SFFAS 6 par. 30, d. 6; SFFAS 16, par. 5)</i>		
<i>Depreciation expense is calculated through systematic and rational allocation of the cost of PP&E, less its estimated salvage or residual value, over its estimated useful life. A composite or group methodology¹ whereby the cost of PP&E is allocated using the same allocation rate, is permissible. (SFFAS 6, par. 30; SFFAS 20, par. 9 item f)</i>		
101. Is depreciation expense recognized on all general PP&E? (SFFAS 6, par. 30)		
102. If historical cost information has not been maintained for existing PP&E, does the entry depreciate at a rate that the estimated net remaining cost over its remaining useful life is a systematic and rational manner? (SFFAS 6, par. 30, 40, & 41)		
103. In an exchange transaction with a non-federal entity, is the difference between the book value (i.e., cost less accumulated depreciation) of PP&E surrendered and the cost of PP&E acquired recognized as either a gain or a loss? (SFFAS 6, par. 32)		
104. In the event that cash consideration is included in the exchange transaction with a non-federal entity, is the cost of PP&E acquired either increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received? (SFFAS 6, par. 32)		
105. When assets have been removed from PP&E in anticipation of disposal, retirement, or removal from service, has the entry stopped recording depreciation and amortization expenses for such assets? (SFFAS 6, par. 30 & 39)		
¹ The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have similar characteristics and serve the same function. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of heterogeneous assets having similar characteristics and serve the same function.		
² The cost of the PP&E acquired is recorded at the cost of the PP&E surrendered less any accumulated depreciation or amortization when the fair value of the PP&E surrendered is greater than its historical cost.		

Version 1.0

Preparation for a Real Property Audit

L3-99

When we completed checklist question number 187, we determined that consistent procedures were not used to capitalize PP&E. Since there was a problem with capitalization, there is also a problem with depreciation expense.

In Section IV, Statement of Cost, question 101 asks: "Is depreciation expense recognized on all general PP&E?" If we are not capitalizing the assets property, there is also a problem with depreciation.

Again, this is a material weakness and a breakdown in internal control. In addition, this is a departure from GAAP and violation of the matching principle.

Let's discuss the DoD Financial Management Regulation (DoDFMR).



Establishing Accountability (cont.)



DoDFMR, Volume 6B, Appendix B – Reconciliation Requirements for the Annual Financial Statements

<http://www.dod.mil/comptroller/fmr/>

Version 1.0

Preparation for a Real Property Audit

L3-100

In addition to checklists, there is another reconciliation tool available when preparing annual financial statements. The required reconciliations are contained in the DoDFMR. When conducting the reconciliation, it does not mean the amounts must agree. However, if there are differences between the amounts, the identifiable cause should be supported. There are four sections in this appendix.

The first section shows the reconciliation within the Balance Sheet. For example, there is a reconciliation from Balance Sheet to Balance Sheet or Balance Sheet to Statement of Changes in Net Position. The next three sections show the reconciliation between the annual financial statements and the Report on Budget Execution, the AR(M) 1307, and the Report on Reimbursements (Department of Defense (DD) Form 725). The last section identifies the reconciliations between selected accounts in support of the Statement of Net Cost and Net Cost and Statement of Financing.

In Section III, there is a reconciliation that is required for the transfers in/out of property in the Statement of Financial Position for Working Capital Fund Reporting Entities only.

Another reconciliation is required in Section IV for general fund and working capital fund entities on cost and capitalization.

Establishing Accountability (cont.)

Note 10. General PP&E, Net

As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40 lease term	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	2-5 Or 10	139.1	(96.3)	42.8	96.2
D. Software	S/L	5 or 10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease ¹	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9

¹ See Note 15 on Capital Lease Liability for additional information

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

Version 1.0

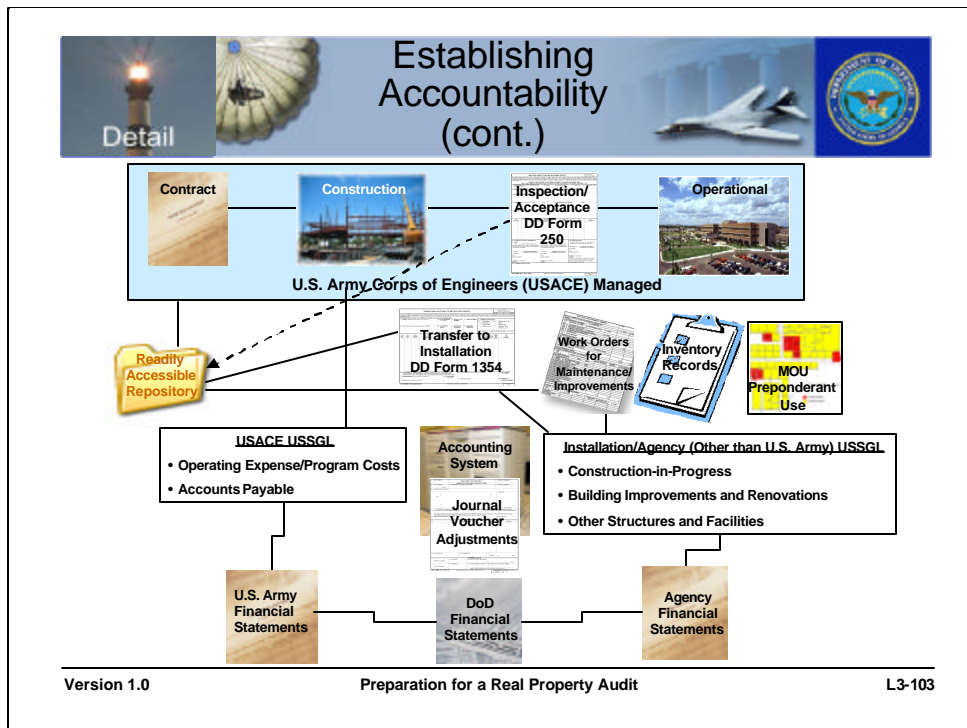
Preparation for a Real Property Audit

L3-102

When we look at Note 10, we see that the dollar amount is the same as on the Balance Sheet which is \$440,898.6 million. After we reconcile the dollar amounts between the Balance Sheet and Note 10, we would select individual items that would be part of the total dollar amount.

Once a sample is taken, we would track those items back to their inception or to the original source document. That example is shown on the next slide.

Let's look at a sample transaction.



We have reconciled the Balance Sheet to Note 10. A sample of transactions has been made. Now we are going to look at the transaction back to its inception.

We would take this transaction through the contract stage, receipt of the item, in service date, capitalization and depreciation, and make sure it is properly accounted for on the property management and financial management systems.

In examining the effect of a transaction and its related documentation and general ledger entries on the agency's financial statements, let's use the example of a construction project initially managed by the U.S. Army Corps of Engineers at a military installation other than Army.

This diagram depicts various interrelationships involved in developing and subsequent placing in operations of the building. Each of these events require appropriate documentation to support the resulting accounting transactions to be recorded in the general ledgers of the appropriate entity. It shows the capturing of the data at various levels, until the information is summarized in the department's financial statements.

Let's summarize the lesson.



Lesson Summary



- **Legislative and Regulatory Guidance**
- **FAM and GAO Yellow Book**
- **Internal Control**
- **Rules for Real Property**

Version 1.0

Preparation for a Real Property Audit

L3-104

In this lesson, you learned legislative and regulatory guidance on preparing financial statements, internal control, performance measurements, establishing a CFO in each agency, improving financial management systems, Presidential strategy to improve management and performance, and the role of the DoD OIG in conducting federal audits.

We discussed the GAO/PCIE FAM and how it's used in performing financial audits of federal agencies, and how the methodology relates to auditing and attestation standards.

You learned about the GAO Yellow Book and how it publishes standards for auditor's responsibility. The Yellow Book also contains information on government audits, general standards, field work standards, and audit reporting.

We discussed the guidance and importance of internal control and how they relate to accountability and effectiveness of Federal programs.

You learned about the memorandums for Financial Improvement Initiative Business Rules and the Financial Improvement Initiative Assertion Package Criteria and Organization. These two memorandums are important in order to get an unqualified audit opinion.

Let's continue the lesson summary.



Lesson Summary (cont.)



- **Roles and Responsibilities**
- **Discovery and Correction**
- **Validation**
- **Assertion**
- **Assessment**
- **Audit**
- **Establishing Accountability**

Version 1.0

Preparation for a Real Property Audit

L3-105

You also learned in this lesson the roles and responsibilities of the auditor, auditee, managers, DFAS, reporting entities, and guidance for OMB Circular No. A-123.

The Discovery and Correction Phase of the business rules was discussed. You learned that during this phase, management identifies deficiencies and implements corrective action. They prepare improvement plans, identify deficiencies and systemic problems, identify material weaknesses, prepare corrective action plans, incorporate effective oversight. During the Validation Phase, management validates financial information after corrective actions are completed.

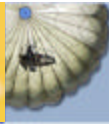
You learned in the Assertion Phase, management affirms to the DoD OIG the reliability of the financial information, and the assertion package is prepared.

The Assessment Phase consists of accomplishing the audit steps outlined in the Planning Phase and Internal Control Phase of the FAM.

During the Audit Phase, the DoD OIG audits the organization's financial statements that management asserted were ready for audit and that passed the DoD OIG assessment.

We mentioned that the GPRA required all agencies to measure their performance using metrics and measures. Metrics provide indicators of the organization's health and demonstrate accountability. The various metrics translate an organization's vision and strategy into a set of measures built around four perspectives: financial, customer, internal business practices, and innovation and learning.

The following slides list references available for additional information.



References



GPRA:

<http://www.whitehouse.gov/omb/mgmt-gpra/gplaw2m.html>

OMB Circular A-11:

<http://www.whitehouse.gov/omb/circulars/a11/02toc.html>

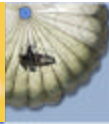
CFO Act: <http://www.oirm.nih.gov/itmra/cfoact.html>

GRMA:

http://www.whitehouse.gov/omb/financial/offm_legislation.html

FMFIA:

<http://whitehouse.gov/omb/financial/print/FMFIA1982.html>



References (cont.)



FFMIA:

http://whitehouse.gov/omb/financial/ffs_FFMIA.html

Clinger Cohen Act: <http://irm.cit.nih.gov/policy/itmra.html>

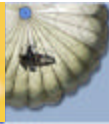
PMA: <http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>

GAO: <http://www.gao.gov/index.html>

GAO Yellow Book: <http://www.gao.gov/govaud/yb01/htm>

GRMA:

http://www.whitehouse.gov/omb/financial/offm_legislation.html



References (cont.)



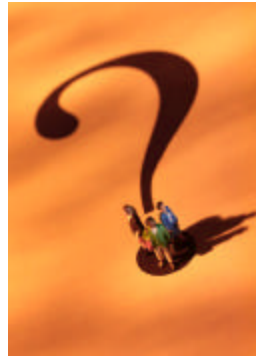
OMB Circular A-123:

<https://www.whitehouse.gov/omb/circulars/a123/a123/html>

DoDFMR: <http://www.dod.mil/comptroller/fmr/>

**Executive Order 13327, Federal Real Property Asset
Management:**

<http://www.whitehouse.gov/news/releases/2004/02/20040204-1.html>



Do you have any questions on the material covered in this lesson? Let's continue with Review 3, Process Memo and Checklist Practice Exercise.

This page intentionally left blank.

Review 3. Process Memo and Checklist Practice Exercise

Directions	<p>This is an open-book practice exercise to assess your knowledge of Lesson 3, Using Tools to Prepare for Audits, with emphasis on preparing the assertion package, including the process memo and checklist.</p> <p>There is one problem contained in this exercise and the solution can be placed on the next page. There may be more than one correct answer, but the idea is to think through the steps required and describe the problem.</p>
Time Allocation	<p>The time allocated to this practice exercise is 15 minutes: 10 minutes for the exercise and 5 minutes for the review and discussion.</p>
Problem	<p>Write your solution to the second bullet of item number 7 on Page R3-11 of the attached Cycle Memorandum/Process Memorandum (Figures R3-7 through R3-9).</p> <p>Discuss the on-going monitoring activities that occur within your office/organization.</p> <p>Next, review Step 1 on page R3-4 of the checklist (Figures R3-2 through R3-6) to discuss the control points that are established by the on-going monitoring activities described within your office/organization.</p>

Possible Solution

TOPIC	CHECKLIST STEP
Process Cycle Memos and Flow Charts	1
GL Transaction Detail/Support	2
Evidential Matter	3
Validation Summary (Management Assertion Letter, Completed Assertion Checklist, and Validation Work Products such as completed GAO Checklists, etc)	4
Status of FIP Corrective Actions	5
Summary of Corrective Actions Taken	6
Organization Charts/Contact Lists	7
FISCAM and SAS 70/88 Audit Date(s) and POCs	8
FISCAM and SAS 70/88 Audit Results	9
Hardware, Software, and Interfaces	10
Type of Data Produced	11
Telecom/Network Information	12
Certifications/Accreditations	13
System/End User Locations	14
Location of Systems Documentation	15
Data Type/Summary of Transactions (Number, Type, Dollar Value)	16
List of Authorized Users	17
List of On-Going or Planned Reviews	18

Figure R3-1, *Checklist Table of Contents for Assertion Package Checklist*

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	1	Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that make up the balance(s) being asserted as ready for audit.	Place cycle/process memorandum, flow documents, questionnaires, directives, and procedures at TAB 1 of the assertion package.	<p>A flowchart(s) is required for each major process and a cycle/process memorandum (a description of a cycle memorandum is in the GAO Financial Audit Manual Section 390.04, “Cycle Memorandum and Flowchart”) should be provided to:</p> <ul style="list-style-type: none"> • accurately describe the regulations followed for the process, • document procedures utilized, • document key control techniques, • identify systems used at the departmental level, and • include the management control objectives and risk assessments. <p>Review the flowchart(s), cycle/process memorandum, and supporting documents for reasonableness and completeness for each process listed.</p>
	2	Have all General Ledger transaction detail and supporting information from feeder systems available for all other transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.	Place supporting GL transaction detail information at TAB 2 of the assertion package.	<p>Review the provided detailed description/flow chart of the reconciliation process performed. The detailed description should describe how the line item balance is fully supported by the General Ledger, the General Ledger is fully supported by the Subsidiary Ledgers, and each transaction in the Subsidiary Ledgers is supported by the appropriate supporting evidential matter. The description should demonstrate that the data is readily available and should provide POCs for the data.</p>

Figure R3-2, Assertion Package Checklist (Steps 1 and 2)

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	3	Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expedient retrieval.	Where practical, include Evidential Matter at TAB 3 , if space does not permit, include detailed information of where the evidential matter is located.	Review the description of the supporting evidential matter (i.e. contracts, invoices, receiving reports, etc.) for reasonableness and completeness. Verify that the location of the supporting evidential matter is identified.
	4	Prepare a summary of validation work performed by management Service auditors, Internal auditors, or independent public accounting firms to establish audit readiness, as applicable.	Place Validation Summary, the Management Assertion Letter, the completed assertion package checklist, and validation work products in TAB 4 .	<p>Verify the presence of the Management Assertion Letter. Verify Validation Summary is present, describes validation methodology, and appears reasonably complete and accurate.</p> <p>Verify the separation of duties between the persons generating the assertion packages and the persons validating the assertion packages. If separation of duties does not exist, review the adequacy of management's explanation of why it deemed separation of duties was not needed.</p>
	5	Complete all the corrective actions in your Mid-Range Financial Improvement Plan (FIP) for the material deficiencies related to the balance(s) being asserted.	Place a statement in TAB 5 that all corrective actions in the FIP related to material deficiencies associated with this line are completed.	Verify that the Management Assertion letter includes a statement that corrective actions identified in the FIP are completed. Also include the comprehensive corrective action plans for deficiencies if not part of FIP.
	6	Using the information from step 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.	Place a status of all FIP corrective actions related to the assertion in TAB 6 .	<p>Verify that the Validation Summary includes:</p> <ul style="list-style-type: none"> • a summary of the corrective actions completed for all known material weaknesses and reportable conditions related to the assertion, OR • a reference to the FIP which documents the completion of all corrective actions related to the assertion.

Figure R3-3, *Assertion Package Checklist (Steps 3-6)*

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	7	Compile organization charts indicating key personnel and their responsibilities and phone lists.	Place organization charts at TAB 7 of the assertion package.	Verify that the packages include organization charts for the financial and information technology process owners. The responsible key Government and contractor personnel, their location and contact information provided.
	8	For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 70/88 audit conducted on the systems? <ul style="list-style-type: none"> • If yes, provide the date and point of contact and proceed to step 9. • If no, proceed to step 10. 	Place FISCAM / SAS Audit date and POC info at TAB 8 of the assertion package.	Review to verify that the packages include dates and POC info for any FISCAM or SAS 70/88 audit reports on systems identified in step 1.
	9	For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10. If a FISCAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the information in steps 10-18 must be gathered prior to audit of each	Place Audit Report(s) at TAB 9 of the assertion package.	Review to verify that FISCAM or SAS 70/88 audit reports are present for all systems identified in step 1. If no audits were performed go to steps 10-18.

Figure R3-4, *Assertion Package Checklist (Steps 7-9)*

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	10	Prepare a description of the major hardware and software of the system and interfaces with other systems.	Place at TAB 10 of the assertion package.	Verify that for each system identified in step 1, a description of the hardware and software is provided. This description should include interface descriptions. At a minimum, the location of the document containing this information should be provided.
	11	Describe what type of data the system produces for the financial statements, e.g., accounting transactions.	Place at TAB 11 of the assertion package	Verify that for each system identified in step 1, a description of the type of data the system produces is provided. At a minimum, the location of the document containing this information should be provided.
	12	Prepare a description of telecommunications devices and networks used with the system.	Place at TAB 12 of the assertion package	Verify that for each system identified in step 1, a description of the telecommunications devices and networks used with the system is provided. At a minimum, the location of the document containing this information should be provided.
	13	Obtain a copy of the most recent certifications and accreditations of the system.	Place at TAB 13 of the assertion package	Verify that for each system identified in step 1, a copy of the most recent certifications and accreditations of the system is provided. For example, this should include the identification of when the last DoD Information Technology Security Certification and Accreditation Process (DITSCAP) certification and accreditation was performed and include a copy of the most recent Systems Security Authorization Agreement (SSAA). At a minimum, the location of the reports, reviews, certifications and accreditations should be provided.

Figure R3-5, *Assertion Package Checklist (Steps 10-13)*

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	14	Identify the system location(s) and end user locations.	Place at TAB 14 of the assertion package	Verify that for each system identified in step 1, a description of the system location(s) and end user locations is provided. At a minimum, the location of the document containing this information should be provided.
	15	Identify the location(s) of system documentation.	Place at TAB 15 of the assertion package	Verify that for each system identified in step 1, location of system documentation is provided.
	16	Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.	Place at TAB 16 of the assertion package	Verify that for each system identified in step 1, provide a description of the type, dollar value, and number of transactions processed in the system in a month and in a year is provided. In addition, the Component should identify which transactions are material to the assertion. At a minimum, the location of the document containing this information should be provided.
	17	List the type of system users – a type of user would be described as a certain category of employees or an organizations activity with-in an Agency.	Place at TAB 17 of the assertion package	Verify that for each system identified in step 1, system user access information (locations and number of users per location) or a description of the types of users is provided. At a minimum, the location of the document containing this information should be provided.
	18	Inquire if there are any ongoing or planned system reviews – if there are, determine when the reviews will be complete.	Place at TAB 18 of the assertion package	Verify that for each system identified in step 1, a description any ongoing or planned system review, as well as planned completion dates, is provided. In addition to the system reviews discussed in Steps 8 and 13, also include a copy of the most recent Financial Management Improvement Act (FFMIA) compliance review, DISA readiness reviews, or any other reviews

Figure R3-6, Assertion Package Checklist (Steps 14-18)

Cycle Memorandum/Process Memorandum	HQ	Base
In accordance with FAM Section 300, this memorandum should be designed to document complete understanding of the internal control structure of the organization as it relates to a specific cycle in the financial accounting process. It should sufficiently address the following areas:		
1. Identify the cycle transactions, significant cycle applications, and significant financial management system.	X	
2. Describe interfaces with other cycles.	X	
3. Identify financial statement line items and general ledger accounts included in the cycle.	X	
4. Include a detailed discussion of policies and procedures related to the processing of the cycle transactions to ensure that necessary actions are taken to address risks.	X	
<ul style="list-style-type: none"> Explain how policies and procedures are communicated to employees (i.e., through policy and financial reporting manuals). 	X	
<ul style="list-style-type: none"> Describe the flow of documents through the financial system (i.e., methods and records established to record, process, summarize, and report entity transactions and maintain accountability of the related assets and liabilities). Explain how the agency : 	X	X
<ul style="list-style-type: none"> initiates transactions 		X
<ul style="list-style-type: none"> identifies and records all valid transactions 		X
<ul style="list-style-type: none"> classifies transactions 		X
<ul style="list-style-type: none"> measures values (including estimates) 	X	X
<ul style="list-style-type: none"> explain how source documentation is used and stored 		X
<ul style="list-style-type: none"> ensures transactions are recorded in the proper time period 		X
<ul style="list-style-type: none"> ensures proper presentation and disclosure of transactions 		X
<ul style="list-style-type: none"> communicates roles and responsibilities of employees 	X	X
<ul style="list-style-type: none"> include a discussion on how the computer system is utilized in the cycle (i.e., how the files are accessed, updated, deleted) 	X	X

Figure R3-7, *Cycle Memorandum/Process Memorandum (Numbers 1-4)*

5. Describe the internal control system.	HQ	Base
<ul style="list-style-type: none"> • Discuss control objectives and their relationship to assertions (see FAM Sections 395B and 395C). Discuss how objectives are evaluated within the organization. 	X	
<ul style="list-style-type: none"> • Discuss performance reviews (i.e. actual vs. budget). 	X	
<ul style="list-style-type: none"> • Discuss information processing (controls in place to check accuracy, completeness and authorization of transactions) including general and application controls. 		
<ul style="list-style-type: none"> • Describe how the agency ensures: 		
<ul style="list-style-type: none"> • Access to assets is permitted only in accordance with management's authorization; 	X	X
<ul style="list-style-type: none"> • The recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences; 	X	X
<ul style="list-style-type: none"> • Transactions are executed in accordance with management's general or specific authorization; 	X	X
<ul style="list-style-type: none"> • Transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements and to maintain accountability for assets. 	X	X
<ul style="list-style-type: none"> • Discuss physical controls (activities that ensure physical security of assets or records, periodic counts, and reconciliations). 	X	X
<ul style="list-style-type: none"> • Discuss segregation of duties (separate authorization, recordkeeping, and asset custody). 	X	X
<ul style="list-style-type: none"> • Assess the control techniques (perform walkthroughs) and follow-up. 	X	X
6. Describe, in detail, any known risks and potential weaknesses and their effects on the financial statements.		
<ul style="list-style-type: none"> • Identify control objectives designed to prevent or detect the misstatements. 	X	X

Figure R3-8, *Cycle/Process Memorandum (Numbers 5-6)*

	HQ	Base
7. Describe the agencies monitoring activities.		
<ul style="list-style-type: none"> Evaluations by internal auditors or other personnel (i.e., communication about strengths and weaknesses and recommendations for improving internal control). 	X	
<ul style="list-style-type: none"> Ongoing monitoring activities (such as supervision). 	X	X
8. Recap prior audit results, including actual testing that was performed.	X	
9. Discuss FFMIA requirements considered to this point, such as system requirements and SGL.		
10. Provide flowcharts detailing the processes followed to complete a transaction. Include:	X	X
<ul style="list-style-type: none"> Input and report documents 	X	X
<ul style="list-style-type: none"> Processing steps 	X	X
<ul style="list-style-type: none"> Files used 	X	X
<ul style="list-style-type: none"> Units involved 	X	X
<ul style="list-style-type: none"> Interfaces with other cycles 	X	X

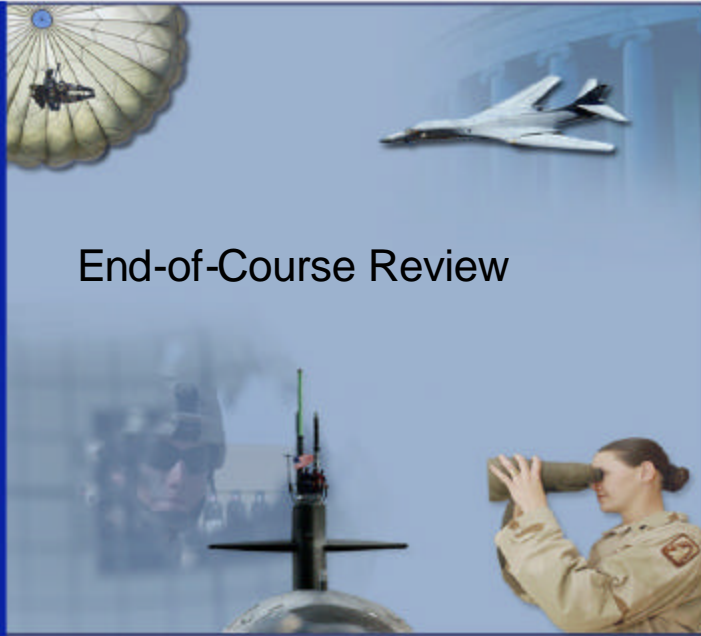
Figure R3-9, *Cycle/Process Memorandum (Numbers 7-10)*

This page intentionally left blank.

Preparation
for a Real
Property
Audit



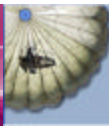
End-of-Course Review



Let's review the course objectives that we discussed today in this course.

You should now be able to analyze components of real property on the DoD financial statements; determine how to evaluate real property for proper recording; and describe how available tools are used to achieve audit compliance.

Let's review the information presented in the lessons.



End-of-Course Review



Lesson 1, Defining Components of Real Property:

- **Real Property**
- **Buildings, Structures, and Facilities**
- **Capital Improvements**
- **Standards and Guidance**
- **Validating Reporting of Statements and Checklist Integrity**

Version 1.0

Preparation for a Real Property Audit

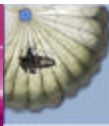
R-2

Lesson 1, Defining Components of Real Property, explained that real property consists of land and improvements to land, buildings and structures (including improvements and additions), and utilities. It includes equipment affixed and built into facilities as integral parts of facilities, such as heating systems. It does not include movable equipment, such as plant equipment. In many instances, real property is synonymous with the term “real estate.”

Primary sources of policy and guidance for real property are the FASAB and the FMR. The FASAB was created as a result of the CFO Act to develop federal accounting standards for real property. The FMR provides policy and guidance for tangible assets.

Lesson 1 also covered proof of statements and the integrity of the checklist as it relates to the annual audited financial statements. When auditors examine the financial statements, they obtain evidential matter to determine if the amounts are appropriate. They determine the validity of the real property on the Balance Sheet and Footnote No. 10 by using the checklist from the Financial Improvement Initiative Business Rules.

Let's review Lesson 2, Recording and Validating Real Property.



End-of-Course Review (cont.)



Lesson 2, Recording and Validating Real Property:

- **Record Real Property Inventory**
- **Preponderant Use**
- **Construction-in-Progress**

Version 1.0

Preparation for a Real Property Audit

R-3

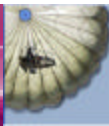
Lesson 2, Recording and Validating Real Property, explained how to record and validate real property as the construction agent sees it and as a customer or user sees it.

The DoD Directive 4165.6 is important guidance when real property is acquired, managed, and disposed of. The lesson explained how the Balance Sheet and Footnote No. 10 state the dollar amounts for General PP&E.

This lesson defined preponderant use, the rules governing the Military Departments' use of real property, the special rule for the use of medical facilities, and the accountability for the real property on financial statements. It also explained the CIP process for several points of view such as the builder, transfer process, and user.

You know that CIP is the classification of real property while it is being built, restored, or modernized. In addition, if the buildings meet or exceed the Department's capitalization threshold of \$100K, they are depreciated using the straight-line method in accordance with the DoDFMR.

Let's continue our review of Lesson 2.



End-of-Course Review (cont.)



Lesson 2, Recording and Validating Real Property (cont.):

- **Financial Statements Implications for Construction Agents**
- **Financial Statements Implications for Users**
- **Business Rules**
- **Using the Checklist to Identify Supporting Documentation**

Version 1.0

Preparation for a Real Property Audit

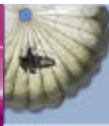
R-4

There are two primary construction agents for the Department: USACE and NAVFAC. You were briefed about the funding process and the relationships between the customer/user and construction agent. Information on the financial implications, and how transactions eventually update accounts on the Balance Sheet and Footnote No. 10 were discussed.

WCFs recognize and depreciate real property regardless of how it is purchased or whether the depreciation is included in the customer's rate. In addition, WCFs maintain assets capitalized on their Balance Sheet under lower thresholds, while general fund activities write the assets off.

Documentation is important to support the receipt of real property. There should be a flowchart to document the audit trail for the different assets. Types of documents include contracts, receiving documents, invoices, and DD Forms 1354. Using the checklist developed, agencies can maintain flowcharts of the proper supporting documentation for all of their real property.

Let's review Lesson 3, Using Tools to Prepare for Audits.



End-of-Course Review (cont.)



Lesson 3, Using Tools to Prepare for Audits:

- **Legislative and Regulatory Requirements**
- **FAM and GAO Yellow Book**
- **Internal Control**

Version 1.0

Preparation for a Real Property Audit

R-5

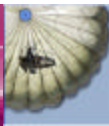
Lesson 3, Using Tools to Prepare for Audits, described legislative and regulatory guidance for preparing financial statements. Internal control includes performance measurements, establishing a CFO in each agency, and improving financial management systems. The Presidential strategy to improve management and performance and the role of the DoDIG in conducting federal audits were explained.

The GAO/PCIE FAM provides guidance for performing financial statements audits of federal entities. It is a tool for enhancing accountability of public funds. The GAO and PCIE work together to ensure that audits of federal entities are high quality, consistent, and cost effective.

The GAO Yellow Book publishes standards for auditors responsibilities. It also contains information on government audits, general standards, field work standards, and audit reporting.

Guidance and the importance of internal control was discussed including how it relates to accountability and effectiveness of federal programs.

Let's continue our review of Lesson 3.



End-of-Course Review (cont.)



Lesson 3, Using Tools to Prepare for Audits (cont.):

- **Rules for Real Property**
- **Roles and Responsibilities**
- **Discovery and Correction**
- **Validation**

Version 1.0

Preparation for a Real Property Audit

R-6

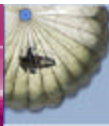
The Financial Improvement Initiative Business Rules and Financial Improvement Initiative Assertion Package Criteria and Organization are two memorandums that are instrumental to getting an unqualified audit opinion.

The roles and responsibilities of the auditor, auditee, managers, DFAS, and reporting entities were explained, along with guidance from the OMB Circular No. A-123.

The Discovery and Correction phase of the business rules management identifies deficiencies and prepares corrective actions. In this phase, management prepares improvement plans, identifies specific deficiencies and systemic problems, identifies material weaknesses, implements corrective action plans, and incorporates effective oversight.

During the Validation phase, management validates the financial information after corrective actions have been completed.

Let's continue our review of Lesson 3.



End-of-Course Review (cont.)



Lesson 3, Using Tools to Prepare for Audits (cont.):

- **Assertion**
- **Assessment**
- **Audit**
- **Balanced Scorecard**

Version 1.0

Preparation for a Real Property Audit

R-7

In the Assertion phase, management at HQ affirms the reliability of the financial information to the DoDIG, and the assertion package is prepared.

In the Assessment phase, the audit steps outlined in the planning phase and internal control phases of the FAM are accomplished.

During the Audit phase, the DoD OIG audits the organization's financial statements that management asserted were ready for audit and that passed the DoD OIG assessment.

The GPRA Act of 1993 requires all agencies to measure their performance with metrics and measures using the Balanced Scorecard. The Balanced Scorecard defines metrics that provide indicators of the organization's health. This traditional Balanced Scorecard model translates an organization's vision and strategy into a set of measures built around four perspectives including financial, customer, internal business practices, and innovation and learning.

Now that we have finished the end-of-course review, it's time to explain the final examination.

This page intentionally left blank.

Appendix A. Glossary

This glossary should serve as a reference tool for DoD personnel who need an understanding of auditing terminology. It is not all-inclusive and reflects both acronyms and terms introduced throughout this course.

ACES	Automated Civil Engineer System
Acquisition	To come into possession or control, by purchase or other means, of an asset or an improvement to an asset.
AcSEC	Accounting Standards Executive Committee (of the AICPA)
ADP	Automated Data Processing is the use of computer equipment to facilitate accounting, budgeting, and other processes.
AFCESA	Air Force Civil Engineering Support Agency
AICPA	American Institute of Certified Public Accountants
AIMD	Accounting and Information Management Division, GAO
Amortization	Periodic recognition of the consumption (expense) of an asset.
AR	Army Regulation
Assertion	Explicit and implicit information provided by management that attests to the represented financial position or results of operations
Assertion Letter	A representation by management that a financial statement or line item is ready for audit
Asset	Property owned by an entity. Assets are classified in several ways, including assets that are tangible and intangible. While tangible assets are more easily defined, intangible assets are those long-lived assets useful in the operation of entity that are not held for sale and have no physical qualities. Examples of intangible assets include patents, copyrights, franchises, trademarks, trade names, and goodwill.
AT&L	Acquisition, Technology, and Logistics is an office located within the Office of the Secretary of Defense.
Auditable	The condition where underlying data and procedures are sufficient, accurate, testable, and reliable enough for an auditor to obtain a basis for forming an unqualified opinion

Audit Ready	The condition where underlying data is auditable and the staff is ready to support that data in an audit process.
Audit Risk	A risk taken when an auditor unknowingly fails to modify his or her opinion appropriately on financial statements that are materially misstated.
Audit Trail	A chain of evidence provided by coding, cross-references, and documentation connecting account balances and other summary results with original transaction data.
BEA	Business Enterprise Architecture is a mechanism to better manage the Department's business operations and to structure the complex systems and organizational interrelationships. (see BMMP)
Benchmark	A standard against which others are measured.
Best Practice	A process or procedure that can be used as a good example for others in similar organizations
BMMP	The Business Management Modernization Program is a vehicle designed to transform business operations and improve oversight and accountability for the billions of dollars spent designing, building, operating, and maintaining business systems and processes that support the Department's primary missions.
BOD	Beneficial Occupancy Date (also Date Placed in Service)
BRAC	Base Realignment and Closure is the Congressional mandate to eliminate excess physical capacity, the operation, sustainment, and recapitalization of that which diverts scarce resources from Defense capability.
CADD	Computer-aided Drafting and Design
Capitalize	To record and carry forward into one or more future periods any expenditure from which the benefits will then be realized.
CEFMS	Corps of Engineers Financial Management System
CFO	A Chief Financial Officer is an organization's senior financial executive.
CFOA	The Chief Financial Officers Act of 1990 is intended to improve financial management systems and information to produce timely, reliable, and comprehensive financial information.
CFOC	The Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies, senior officials of the Office of Management and Budget, and the Department of the Treasury, who work collaboratively to improve financial management in the U.S. government.

CIP	Construction-in-Progress is an asset in the process of completion.
Completeness Assertion	An assertion about whether all transactions and accounts that should be presented in the financial statements are so included.
Compliance	The conformity to the rule of law, standard practice, or specified procedure.
COTS	Commercial Off-the-Shelf – Software
Cycle Memorandum	A depiction in words and/or a diagram form of the activities relating to a particular type of transaction such as the revenue cycle, expenditure cycle, financing cycle, personnel services cycle, or production cycle.
DCAA	The Defense Contract Audit Agency is responsible for performing all contract audits for the Department, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration.
D.C. or DC	District of Columbia
DD	Department of Defense form prefix
DeCA	The Defense Commissary Agency delivers quality of life benefits to the armed services community by efficiently and effectively providing products and services at a lower cost than that available in the retail sector.
Depreciation	The allocation of the cost of an asset over a period of time for accounting and/or tax purposes.
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	The Defense Finance and Accounting Service has the central mission to provide responsive, professional finance and accounting services for the people who defend America.
Deficiency	In an audit, the term deficiency describes a lack in adequate competence, readiness, knowledge, or means. It may be synonymous with fault or defect.
Disclosure	Making something known to the public, as in disclosing the financial position of an entity through the publishing of its financial statements and accompanying notes.
DLA	The Defense Logistics Agency provides worldwide logistical support for the missions of the military departments and the Unified Combatant Commands under conditions of peace and war. It also provides logistics support to other DoD components and certain federal agencies, foreign governments, international organizations, and others as authorized.

DoD	Department of Defense (also referred to as the Department)
DoDD	Department of Defense Directive
DoDFMR	Department of Defense Financial Management Regulation (7000.14-R)
DoD OIG	Department of Defense Office of Inspector General
DWCF	Defense Working Capital Fund
EDA	Electronic Document Access
EDM	Electronic Data Management
ENG	Engineering
Engagement	Describes the process of conducting an audit; the formal agreement to provide a service, as in an audit engagement letter or contract.
Entity	An organization, unit, or body, such as a department, fund, agency, or section.
ESC	Executive Steering Committee
Evidential Matter	Audit evidence that consists of underlying accounting data or financial records and all corroborating information available to an auditor.
Existence Assertion	An assertion about whether assets or liabilities of an entity exist at a given date, and whether recorded transactions have occurred during a given period; also called existence occurrence.
Existence Occurrence	See Existence Assertion.
FAM	The Financial Audit Manual was established by the GAO and the PCIE to ensure that the financial statement audits have their intended outcome.
FAR	The Federal Acquisition Regulation is the official authoritative source for the contracting community.
FASAB	The Federal Accounting Standards Advisory Board promulgates federal accounting standards to support financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.

FASB	The Financial Accounting Standards Board establishes and improves standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. It is officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.
FFMIA	The Federal Financial Management Improvement Act builds on the CFO Act by requiring agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions and to ensure accountability.
FII	The Financial Improvement Initiative promotes the achievement of an unqualified opinion on the Department's consolidated financial statements.
FISCAM	Federal Information System Controls Audit Manual
FMFIA	The Federal Manager's Financial Integrity Act requires federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. It further requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities.
FMMP	The Financial Management Modernization Program was renamed the BMMP on May 20, 2003 (see BMMP).
FMR	Financial Management Regulation (see DoDFMR)
FMS	The Foreign Military Sales program manages government-to-government purchases of weapons and other defense articles, defense services, and military training.
FUDS	Formally Used Defense Sites is a classification of sites for the purpose of environmental cleanup.
FY	Fiscal Year
G&A	General and Administrative
GAAP	Generally Accepted Accounting Principles are the common set of accounting principles, standards, and procedures. GAAP is a combination of authoritative standards (set by policy boards) and the accepted ways of performing accounting.
GAGAS	Generally Accepted Government Auditing Standards

GAO	The Government Accountability Office, previously called the General Accounting Office, is an independent agency that works for Congress. The GAO is often called the “congressional watchdog” because it investigates how the federal government spends taxpayers’ dollars.
GMRA	The Government Management Reform Act of 1994 updated the CFOA by setting standards for the effectiveness of financial management reporting.
GOCO	Government-Owned, Contractor-Operated facilities and equipment.
GPRA	The Government Performance and Results Act of 1993 aims to improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction.
GRS	The General Records Schedule is issued by the Archivist of the United States to provide disposition authorization for records common to several or all agencies of the federal government.
GS	General Schedule is a classification for civilian employment.
GSA	General Services Administration
IAW	In accordance with
ID	Identification (see UID)
IG	The Inspector General has traditionally served as “an extension of the eyes, ears, and conscience of the Commander.” Pursuant to the Inspector General Act of 1978, as amended, “the Inspector General of the Department of Defense shall . . . be the principal adviser to the Secretary of Defense for matters relating to the prevention of fraud, waste, and abuse in the programs and operations of the Department.”
IGT	Intergovernmental Transaction
IMPAC	International Merchant Purchase Authorization Card
IPA	Independent Public Accountant
Internal Control	Processes that are designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, compliance with applicable laws and regulations, and the effectiveness and efficiency of operations.
Internal Review	An inspection of processes and data of an entity by personnel employed by or internal to the entity.

JFMIP	The Joint Financial Management Improvement Program is a joint and cooperative undertaking of the Department of the Treasury, the GAO, the OMB, and the OPM working in cooperation with each other and other agencies to improve financial management practices in government.
Liability	A legal responsibility for an amount owed.
Materiality	In an audit, materiality refers to the degree of importance or consequence.
MC	Management Control (see also MCP)
MCP	A management control program provides reasonable assurance that obligations and costs comply with applicable laws and emphasizes prevention of waste, fraud, mismanagement, and timely corrections of MC weaknesses.
MDA	The Management Discussion and Analysis section, found on financial statements, allows management to discuss aspects of an entity's financial statement that may be otherwise difficult to locate. It provides a summary and more.
MILCON	Military Construction is based on funds provided by Congress.
MIPR	Military Interdepartmental Purchase Request
MOU	A Memorandum of Understanding is a formal, signed agreement.
N/A	Not available (or Not applicable)
NARA	The National Archives and Records Administration ensures ready access to essential evidence and prescribes standards relating to retention of documents.
NATO	North Atlantic Treaty Organization
NAVFAC	Naval Facilities Engineering Command
NDPP&E	National Defense PP&E property is used in active Military Activities and previously expensed in the period incurred, now classified as general PP&E and capitalized, with the exception of the cost of land and land improvements that produce permanent benefits. Land improvements are depreciated.
No.	Number

Non-statistical Sampling	A group of methods used in audits to determine the size of a sample to be tested and the evaluation of the results that is less objective and more subjective and judgmental than the statistical sampling approach.
NRV	Net Realizable Value is a valuation method.
O&M	Operations and Maintenance
OCONUS	Outside continental United States
OFFM	The Office of Federal Financial Management was created within the OMB by the CFOA of 1990. The OFFM is responsible for the financial management policy of the federal government including implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFOA.
OIG	Office of Inspector General
OLRV	On-line Review
OMB	The Office of Management and Budget has a mission to assist the President in overseeing the preparation of the federal budget and to supervise its administration in Executive Branch agencies.
OM&S	Operations, Maintenance, and Supplies
OPM	The Office of Personnel Management is the federal government's human resource agency.
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
OUSD(HA)	Office of the Under Secretary of Defense (Health Affairs)
P&EP	Property and Equipment Policy
PARS	Performance and Accountability Reports
PBC	A Prepared by Client list is a list that facilitates the audit process by coordination with specific points-of-contact.
PCIE	The President's Council on Integrity and Efficiency was established to address integrity, economy, and effectiveness issues that transcend individual government agencies, and increase the professionalism and effectiveness of IG personnel throughout the government.

PMA	The President's Management Agenda is the strategy that the current administration has for improving the management of the federal government. It focuses on five areas of management weaknesses across the government where improvements and the most progress can be made.
PMO	Program Management Office
POC	A Point of Contact is generally a person responsible for providing information or service.
Population	A class of transactions or the account balance to be tested in an audit.
PP&E	Property, Plant, and Equipment is a classification of property for the entity's financial statements.
Qualified Opinion	An auditor's opinion stating that except for the effects of the matter(s) to which the qualification relates, the financial statements present the position of the organization fairly.
Readiness	See Audit Ready.
Reasonable Assurance	Assurance that a reasonable person can reach the same conclusion given the same data and circumstances; not an absolute certainty.
RFA	Ready for Audit
Rights and Obligations Assertion	An assertion about whether assets are the rights of the entity, and liabilities are the obligations for the entity, at a given date.
Risk Adverse	A condition in which an auditor is not willing to accept a moderate or high level of audit risk, usually when the client has a greater likelihood of financial failure or there are many users of the statements and audit reports.
ROS	Reports of Survey
RPC	Review and Prioritization Committee
RPS	Review and Prioritization Sub-committee
Sample	A single unit within a class of transactions or account balances to be tested.
SAS	Statements on Auditing Standards
SEC	Securities and Exchange Commission
SECDEF	Secretary of Defense

SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards is the standards issued by the FASAB to implement the GAAP for the federal government.
SGL	The Standard General Ledger is the chart of accounts used by the Department to properly record all accounting transactions.
SOP	Standard Operating Procedure
Source Documentation	Documents representing authorization for original transactions and associated with transaction data. These documents include contracts, invoices, funding authorizations, bills of lading, receiving reports, titles, mortgages or notes, leases, agreements, appointments, signature cards, policies, and others.
Statistical Sampling	A mathematical method or combination of methods used to determine the number of items in a population to examine.
Systemic	Describes a problem involving one or more financial reporting systems that results in an inability to provide accurate, reliable, or timely financial data.
TDY	Temporary Duty
TFM	Treasury Financial Manual
TI	Treasury Index is the Treasury's code for the various funds used in the federal government. Examples in DoD include TI 97, 57, 21, and 17.
UID	Unique Identifier
Unqualified Opinion	An auditor's opinion that is without any material exception as to a general statement of reliability of the items specified within the limits of an audit.
U.S. or US	United States
USD	Under Secretary of Defense
USD(C)	Under Secretary of Defense, Comptroller
USSGL	United States Standard General Ledger provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.
USTRANSCOM	The United States Transportation Command is a unified command composed of elements from each of the services to provide air, land, and sea transportation for the DoD.

Validation	The corroboration, substantiation, or confirmation of relevant or meaningful information, supported by objective truth or generally accepted authority.
WCF	The Working Capital Fund was established to be self-sustaining where products or services are produced and sold to recover the full cost of operations.

This page intentionally left blank.

Appendix B. Checklist for Federal Accounting, Reporting, and Disclosures

The following are excerpts from Section III of the GAO/PCIE Financial Audit Manual, Part II, Checklist for Federal Accounting, Reporting, and Disclosures.

Section III

Balance Sheet

Assets	Yes, No or N/A	Explanation
General Property, Plant, & Equipment (Net) (187– 233)		
<i>General property, plant, and equipment (PP&E) are any property, plant, and equipment used in providing goods or services. (SFFAS 6, par. 23)</i>		
187. Has the entity established, disclosed, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (SFFAS 6, par. 13)		
188. Does the entity follow a policy that ensures its PP&E consists of tangible assets, including land, that meet the following criteria? a. have estimated useful lives of 2 years or more b. are not intended for sale in the ordinary course of operations c. are acquired or constructed with the intention of being used or being available for use by the entity (SFFAS 6, par. 17)		
189. Does PP&E consist of the following items? a. assets acquired through capital leases, including leasehold improvement b. property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, federal contractors) c. land rights (SFFAS 6 par. 18)		
<i>Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. Operating leases are leases in which the federal entity does not assume the risks of ownership of PP&E. Multiyear service contracts and multiyear purchase agreements for expendable commodities are not capital leases. (SFFAS 6, par. 20, footnote 22; SFFAS 5, par. 43)</i>		

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187- 233)	Yes, No or N/A	Explanation
<p>190. Does the entity classify a lease as a capital lease if at its inception the lease meets one or more of the following criteria?</p> <ul style="list-style-type: none"> a. the lease transfers ownership of the property to the lessee by the end of the lease term b. the lease contains an option to purchase the leased property at a bargain price c. the lease term is equal to or greater than 75 percent of the estimated economic life of the leased property, and the beginning of the lease term does not fall within the last 25 percent of the total estimated economic life of the property d. the present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property, and the beginning of the lease term does not fall within the last 25 percent of the total estimated economic life of the property (SFFAS 6, par. 20; SFFAS 5, par. 43) 		
<p>191. Does the general PP&E asset line item exclude the following items?</p> <ul style="list-style-type: none"> a. items held in anticipation of physical consumption such as operating materials and supplies b. items the federal entity has a reversionary interest in c. heritage assets (except multiuse heritage assets)²⁴ d. stewardship land (i.e., land not included in general PP&E) (SFFAS 6, par. 19, 21, 57, 58, & 68; SFFAS 16, par. 6) 		

²⁴Multiuse heritage assets are heritage assets used predominately in general government operations (e.g., the main Treasury building, which is used as an office building).

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
<p>192. In determining the level at which the entity categorizes its PP&E, has the entity considered the following factors?</p> <ul style="list-style-type: none"> a. the cost of maintaining different accounting methods for property and the usefulness of the information b. the diversity of the PP&E (e.g., useful lives, value, alternative uses) c. the programs being served by the PP&E d. future disposition of the PP&E (SFFAS 6, par. 22) 		
<p>193. Does the entity categorize an asset under general PP&E if it has one or more of the following characteristics?</p> <ul style="list-style-type: none"> a. it could be used for alternative purposes (e.g., by other federal programs, state or local governments, nongovernmental entities) but is used to produce goods or services or to support the mission of the entity b. it is used for business-type activities²⁵ c. it is used by entities in activities whose costs can be compared to those of other entities performing similar activities (e.g., federal hospital services in comparison to other hospitals) (SFFAS 6, par. 23; OMB Bulletin 01-09, p. 22, section 3.3) 		
<p>194. Is PP&E of entities operating as business-type activities categorized as general PP&E whether or not it meets the definition of other PP&E categories (e.g., heritage assets)? (SFFAS 6, par. 24; OMB Bulletin 01-09, p. 22, section 3.3)</p>		

²⁵ A business-type activity is defined as a significantly self-sustaining activity that finances its continuing cycle of operations through the collection of exchange revenue.

Section III
Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
195. Are land and land rights specifically acquired for or in connection with other general PP&E included in general PP&E? (SFFAS 6, par. 25; OMB Bulletin 01-09, p. 22 & 23, section 3.3)		
196. Is all general PP&E recorded at cost? (SFFAS 6, par. 26)		

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
<p>197. Does the cost of general PP&E include all costs incurred to bring the PP&E to a form and location suitable for its intended use, such as the following?</p> <ul style="list-style-type: none"> a. amounts paid to vendors b. transportation charges to the point of initial use c. handling and storage costs d. labor and other direct or indirect production costs (for assets produced or constructed) e. costs of engineering, architectural, and other outside services for designs, plans, specifications, and surveys f. acquisition and preparation costs of buildings and other facilities g. an appropriate share of the cost of the equipment and facilities used in construction work h. fixed equipment and related installation costs required for activities in a building or facility i. direct costs of inspection, supervision, and administration of construction contracts and construction work j. legal and recording fees and damage claims k. fair value of facilities and equipment donated to the government l. material amounts of interest costs paid (SFFAS 6, par. 26) 		
<p>198. Is the cost of general PP&E acquired under a capital lease equal to the amount recognized as a liability²⁶ for the capital lease at its inception? (SFFAS 6, par. 29)</p>		

²⁶The liability is the net present value of lease payments unless the net present value of the lease payments exceeds the fair value of the asset, in which case the amount recorded as the liability would be the fair value of the asset. (SFFAS 5, par. 44)

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
199. Is the cost of general PP&E acquired through donation, will, or judicial process, excluding forfeiture, capitalized at estimated fair value at the time acquired by the government? (SFFAS 6, par. 30)		
200. Is general PP&E transferred from other federal entities capitalized at the book value recorded by the transferring entity? (SFFAS 6, par. 31)		
201. Is general PP&E transferred from other federal entities capitalized at the fair value at the time of the transfer, if the receiving entity cannot reasonably ascertain the book value of the PP&E being transferred? (SFFAS 6, par. 31)		
202. If general PP&E is acquired through exchange between a federal entity and a nonfederal entity, is it capitalized at the fair value of the PP&E surrendered at the time of the exchange? (SFFAS 6, par. 32)		
203. If general PP&E is acquired through exchange between a federal entity and a nonfederal entity and the fair value of the PP&E is more readily determinable than that of the PP&E surrendered, is the acquired general PP&E capitalized at its fair value? (SFFAS 6, par. 32)		
204. If general PP&E is acquired through exchange between a federal entity and a nonfederal entity and neither the fair value of the PP&E acquired or surrendered is determinable, is the acquired general PP&E capitalized at the book value of the PP&E surrendered? (SFFAS 6, par. 32)		
205. If cash is included in an exchange of general PP&E between a federal entity and a nonfederal entity, is the cost of PP&E acquired increased by the amount of cash surrendered or decreased by the amount of cash received? (SFFAS 6, par. 32)		

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
206. For general PP&E acquired through exchange between a federal entity and a nonfederal entity, is any difference between the net recorded amount of the PP&E surrendered and the cost of the PP&E acquired recognized as a gain or loss? (SFFAS 6, par. 32)		
207. Is PP&E recognized when title passes to the acquiring entity or when PP&E is delivered to the entity or to an agent of the entity? (SFFAS 6, par. 34)		
208. If general PP&E is under construction, is it recorded as construction work in process until it is placed into service and transferred to general PP&E? (SFFAS 6, par. 34)		
<i>Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage or residual value over its estimated useful life. (SFFAS 6, par. 35, OMB Bulletin 01-09, p. 23, section 3.3)</i>		
209. Is depreciation expense recognized on all general PP&E, except land and land rights of unlimited duration? (SFFAS 6, par. 35)		
210. Do estimates of useful life of general PP&E consider such factors as physical wear and tear and technological change? (SFFAS 6, par. 35)		
211. Are changes in estimated useful life or salvage and residual value of general PP&E accounted for in the period of change and future periods? (SFFAS 6, par. 35)		
212. Is the depreciation method systematic, rational, and best reflective of the use of the PP&E, including the use of a composite or a group methodology ²⁷ whereby the costs of PP&E are allocated using the same allocation rate? (SFFAS 6, par. 35; SFFAS 23, par. 9(f))		

²⁷The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogenous assets having similar characteristics and service lives.

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
213. Are depreciation and amortization expenses accumulated in contra-asset accounts? (SFFAS 6, par. 36)		
214. Are costs that either extend the useful life of existing general PP&E or enlarge or improve its capacity capitalized and depreciated/amortized over the remaining useful life of the asset? (SFFAS 6, par. 37)		
215. When general PP&E is disposed of, retired, or removed from service, is the asset removed from the asset accounts along with the associated accumulated depreciation/amortization? (SFFAS 6, par. 38)		
216. Are the differences between the book value of the PP&E and the amounts realized, recognized as a gain or loss in the period that the general PP&E is disposed of, retired or removed from service? (SFFAS 6, par. 38)		
217. Is general PP&E removed from general PP&E accounts along with associated accumulated depreciation/amortization if prior to disposal, retirement, or removal from service, it no longer provides service in the operations of the entity? (SFFAS 6, par. 39)		
218. Is such PP& E that has been removed from the asset accounts recorded in an appropriate asset account at its expected net realizable value? (SFFAS 6, par. 39)		
219. Is any difference in the book value and its expected net realizable value of the about-to-be disposed, retired, or removal-from-service PP&E recognized as a gain or loss in the period of adjustment? (SFFAS 6, par. 39)		
220. Is the expected net realizable value of such PP&E assets adjusted at the end of each accounting period, and are any further adjustments in value recognized as a gain or loss? (SFFAS 6, par. 39)		

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
221. If historical cost information for existing general PP&E has not been maintained, are cost estimates based on either of the following costs? a. the cost of similar assets at the time of acquisition b. the current cost of similar assets discounted for inflation since the time of acquisition (SFFAS 6, par. 40)		
222. For general PP&E previously considered national defense PP&E, is the initial capitalization amount for these assets the initial historical cost for the items including any major improvements or modifications? (SFFAS 23, par. 10)		
223. For general PP&E previously considered national defense PP&E where obtaining initial historical cost is not practical, is estimated historical cost used, based on one of the following alternatives? a. current replacement cost of similar items, deflated through the use of price-level indexes to the acquisition year or estimated acquisition year if the actual year is unknown b. other information indicating amount expended, such as budget, appropriation, or engineering documents and other reports reflecting amounts expended c. other reasonable approaches for estimating historical cost ²⁸ (SFFAS 23, par. 12 & 13)		
224. For general PP&E previously considered national defense PP&E that was in service upon implementation of SFFAS 23, are cleanup cost liabilities adjusted as needed? ²⁹ (SFFAS 23, par. 15)		

²⁸For example, the latest acquisition cost may be substituted for current replacement cost in some situations.

²⁹This adjustment may be needed because the Department of Defense may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment (per paragraph 101 of SFFAS 6).

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
<p>225. Is accumulated depreciation/amortization recorded based on one of the following methods?</p> <ul style="list-style-type: none"> a. the estimated cost of the PP&E and the number of years the PP&E has been in use relative to its estimated useful life b. the PP&E's estimated net remaining cost³⁰ and the depreciation/amortization charged over the remaining life based on that net remaining cost c. a composite or a group methodology whereby the costs of PP&E are allocated using the same allocation rate (SFFAS 6, par. 41; SFFAS 23, par. 9(f)) 		
<p>226. If general PP&E would have been substantially depreciated or amortized had it been recorded upon acquisition, does the entity weigh materiality and cost-benefit in considering either of the following alternatives?</p> <ul style="list-style-type: none"> a. record only improvements made during the period beyond the initial expected useful life of general PP&E b. make an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building-by-building estimate). (SFFAS 6, par. 42) 		
<p>227. In recording existing general PP&E, is the difference in amounts added to asset and contra-accounts credited (or charged) to the net position of the entity, with the amount of the adjustment shown as a "prior period adjustment" in the Statement of Changes in Net Position? (SFFAS 6, par. 43)</p>		

³⁰Net remaining cost is the original cost of the asset less any accumulated depreciation/amortization to date (i.e., book value).

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187– 233)	Yes, No or N/A	Explanation
228. In recording existing general PP&E previously identified as national defense PP&E, is the difference in amounts added to asset and contra accounts reported as a “change in accounting principle” and reflected as an adjustment to the beginning balance of cumulative results of operations in the statement of changes in net position, for the period the change is made? (SFFAS 23, par. 10 & 16)		
229. Does the entity make the following minimum disclosures about its general PP&E? a. the cost, associated accumulated depreciation, and book value by major class (e.g., building and structures, fixtures, equipment) b. the estimated useful lives for each major class c. the method(s) of depreciation for each major class d. capitalization threshold(s) including any changes in thresholds(s) during the period e. restrictions on the use or convertibility of general PP&E (SFFAS 6, par. 45; OMB Bulletin 01-09, p. 77, section 9.10)		
<p><i>Property, plant, and equipment are classified as heritage assets if they have (1) historical or natural significance; (2) cultural, educational, or artistic importance; or (3) significant architectural characteristic. (SFFAS 6, par. 57)</i></p> <p><i>Multiuse heritage assets are heritage assets that are predominately used in general government operations (e.g., buildings such as the main Treasury building, which is used as an office building). (SFFAS 16, par. 6; OMB Bulletin 01-09, p. 23, section 3.3)</i></p>		
230. If the predominant use of the heritage asset(s) is in general government operations, is the acquisition, betterment, or reconstruction of the asset(s) capitalized as general PP&E and depreciated over its useful life? (SFFAS 16, par. 6 & 9; OMB Bulletin 01-09, p. 23, section 3.3; p. 98, section 10.2A)		

Section III

Balance Sheet

Assets General Property, Plant, & Equipment (Net) (187- 233)	Yes, No or N/A	Explanation
231. Does the entity also include a footnote disclosure explaining that "physical quantity" information for the multiuse heritage assets is included in supplemental stewardship reporting for heritage assets? (SFFAS 16, par. 9; OMB Bulletin 01-09, p. 23, section 3.3; p. 98, section 10.2A)		
232. Are multiuse heritage assets acquired through donation or devise recognized as general PP&E at the assets' fair value? (SFFAS 16, par. 11)		
233. For multiuse heritage assets acquired through donation or devise, are the assets fair value also recognized as "nonexchange revenue," as defined in SFFAS 7? (SFFAS 16, par. 11)		

Section III

Balance Sheet

Assets Software (234– 262)	Yes, No or N/A	Explanation
<p><i>Software includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program.</i></p> <p><i>“Internal use software” is software that is purchased from commercial vendors “off the shelf,” internally developed, or contractor-developed solely to meet the entity’s internal or operational needs. (SFFAS 10, par. 8)</i></p>		
<p>234. Does the entity capitalize the cost of software when such software meets the following criteria?</p> <ul style="list-style-type: none"> a. specifically identifiable b. determinate life of 2 years or more c. not intended for sale in the ordinary course of operations d. acquired or developed with the intention of being used by the entity e. meets the criteria for general property, plant, and equipment in that it is used in providing goods and services (SFFAS 6, par. 17; SFFAS 10, par. 15 & 38) 		
<p>235. Does the capitalized cost of internally developed software include the full cost (i.e., direct and indirect costs) incurred during the software development stage? (SFFAS 10, par. 16)</p>		

This page intentionally left blank.

Appendix C. Financial Improvement Initiative Checklist

The following is a checklist included in the Financial Improvement Initiative Business Rules Memo.

CHECKLIST	
<p>When performing corrective action validation and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.</p> <p>This check list is designed to help components prepare for audits by providing the information that is typically needed for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditors in the form of a "Prepared By Client (PBC) List."</p> <p>The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in validating that these steps have been completed.</p>	
<input type="checkbox"/>	<p>1 Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that makes up the balance(s) being asserted as ready for audit.</p>
<input type="checkbox"/>	<p>2 Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.</p>
<input type="checkbox"/>	<p>3 Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expedient retrieval.</p>
<input type="checkbox"/>	<p>4 Prepare a summary of the validation work performed by management Service auditors, internal auditors, or independent public accounting firms to establish audit readiness, if applicable.</p>
<input type="checkbox"/>	<p>5 Complete all the corrective actions in your Mid-Range Financial Improvement Plan for the material deficiencies related to the balance(s) being asserted.</p>
<input type="checkbox"/>	<p>6 Using the information from number 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.</p>
<input type="checkbox"/>	<p>7 Compile organization charts indicating key personnel and their responsibilities and phone lists.</p>
<p>8 For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 70/88 audit conducted on the systems?</p>	
<input type="checkbox"/>	<p>Yes If yes, provide the date and point of contact.</p>
<input type="checkbox"/>	<p>No</p>

- ☐ 9 For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10.

If a FISCAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the following information will have to be gathered prior to the audit for each system.

- ☐ 10 Prepare a description of the major hardware and software of the system and interfaces with other systems
- ☐ 11 Describe what type of data the system produces for the financial statements, e.g. accounting transactions
- ☐ 12 Prepare a description of telecommunications devices and networks used with the system.
- ☐ 13 Obtain a copy of the most recent certifications and accreditations of the system.
- ☐ 14 Identify the system location(s) and end user locations.
- ☐ 15 Identify the location(s) of system documentation.
- ☐ 16 Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.
- ☐ 17 Obtain a list of all system users - this should be a print out that shows the user and level of access.
- ☐ 18 Inquire if there are any ongoing or planned system reviews - if there are, determine when the reviews will be complete.

Office of the Under Secretary of Defense (Comptroller) (OUSD(C))



Preparation for a Real Property Audit

Final Examination

Student Name: _____

Prepared by:
Science Applications International Corporation
Southbridge Hotel and Conference Center
14 Mechanic Street, Room C-3100
Southbridge, MA 01550-2570



Products or brand names mentioned in the text of this guide
are trademarks or registered trademarks of their respective holders

Final Examination

Directions This is an open-book final examination covering subject matter taught in this course. It will assess your knowledge of requirements for preparing for a real property audit. The final examination consists of questions that are multiple choice and fill in the blank. Write in or circle the correct answer to the questions.

Time Allocation The time allocated to this examination is 40 minutes: 30 minutes for the exercise and 10 minutes for the critique.

Number	Question
1	What is the threshold dollar amount for DoD capitalization? a. \$25,000 b. \$100,000 c. \$200,000 d. \$10,000
2	What are the three categories of PP&E? _____ _____ _____
3	A 100 percent physical inventory of all real property should be conducted every how many years? a. 2 years b. 3 years c. 4 years d. 5 years

Number	Question
4	<p>According to DoD Directive 4165.6, acquisition, management, and disposal of real property are functions of what activity?</p> <ul style="list-style-type: none">a. General Accountability Officeb. Chief Financial Officersc. Military Department acting on behalf of the DoDd. Office of the Under Secretary of Defense, Comptroller (OUSD(C))
5	<p>When military real property is transferred between departments within the DoD, what DD form is used?</p> <ul style="list-style-type: none">a. DD Form 1155b. DD Form 250c. DD Form 1354d. DD Form 1556
6	<p>What regulation contains Table 6-7, DoD Recovery Periods for Depreciable General PP&E Assets?</p> <ul style="list-style-type: none">a. GAO/PCIE Financial Audit Manualb. DoDFMRc. AR 405-45, Real Property Inventory Managementd. DFAS Manual 37-100
7	<p>Who are the two primary construction agents for the DoD?</p> <hr/> <hr/>

Number	Question
8	<p>What law did Congress enact requiring federal agencies to designate a Chief Financial Officer to prepare annual financial statements?</p> <ul style="list-style-type: none">a. Office of Management and Budget Circular A-11b. Federal Managers Financial Integrity Actc. Chief Financial Officers Actd. President's Management Agenda
9	<p>The GAO Yellow Book contains standards for audits of government organizations, programs, activities, and functions. What are these standards often called?</p> <ul style="list-style-type: none">a. GAAPb. SFFASc. SFFACd. GAGAS
10	<p>The Financial Improvement Initiative Business Rules are used by DoD entities to obtain what type of audit opinion?</p> <ul style="list-style-type: none">a. Disclaimerb. Qualified opinionc. Unqualified opiniond. Satisfactory opinion
11	<p>What entity is the independent auditor for the DoD and provides for independent reviews of agency programs and operations?</p> <ul style="list-style-type: none">a. Army Audit Agencyb. Internal Review and Audit Compliance Officec. DoD OIGd. DoD Finance and Accounting Office

Number	Question
12	<p>During what phase of the Financial Improvement Initiative does management affirm the reliability of the financial information?</p> <ul style="list-style-type: none">a. Discovery and Correction Phaseb. Validation Phasec. Assertion Phased. Assessment Phase
13	<p>What is the name of the act requiring federal agencies to measure their performance using metrics and measurements?</p> <ul style="list-style-type: none">a. Clinger-Cohen Actb. GAO/PCIE Financial Audit Manualc. Chief Financial Officers Actd. Government Performance and Results Act
14	<p>List the four perspectives that the Balanced Scorecard is built around.</p> <hr/> <hr/> <hr/> <hr/>
15	<p>What two approaches do auditors use to conduct physical inventories of real property?</p> <ul style="list-style-type: none">a. LIFO and FIFOb. Moving Average and LIFOc. Wall-to-wall and Moving Averaged. Cycle Count and Wall-to-wall